

Polish Banks Big Picture – December 2013

Themes for 2014 and 2015

- **Regulation, “Province” Recovery, Investments** — In our opinion 2013 was the year of 1) deposit re-pricing; 2) changes in asset mix driven by gradual FX mortgage repayment and rising production of consumer loans; and 3) usage of accumulated reserves (e.g. booking gains on bonds). We think that 2014-15 will be years of 1) regulation, legislation and litigation (see p. 6 for details); 2) increasing capital return; 3) driven by a macro recovery, an outperformance of “provincial banks” over “big city banks”; and 4) gradually rising revenues from investment products.
- **Stable Trends in Loans and Deposits** — In December 2013 retail lending continued to accelerate and FX-adjusted growth in mortgage loans reached +6.6% yoy (vs. +6.5% in November 2013), while growth in non-mortgage retail loans was +3.9% yoy vs. +3.4% yoy in the previous month. Corporate loans increased 0.8% yoy (vs. +0.5% yoy in November). Retail deposits rose +6.4 yoy (vs. +6.4% yoy in November), while corporate deposits grew by +9.6% yoy (vs. +7.4% yoy in the previous month).
- **Lower NPL Ratio** — In December 2013 the sector NPL ratio (impaired loans-to-total-loans) fell to 8.5% from 8.6% in the previous month, mainly due to lower consumer NPL ratio (14.7% vs. 14.9% in November) and corporate NPL ratios (11.5% vs. 11.7%, respectively), while the mortgage NPL ratio grew slightly to 3.14% from 3.13%.
- **Stable Term Deposit Spread** — In December 2013 the spread on new term (1-3 month) retail deposits decreased to -9bp from -18bp in November 2013, while the spread on new mortgages was flat at 2.49% and the spread on new corporate lending grew to 1.76% from 1.61%.
- **Banking Sector Results** — Net profit of banking sector in December 2013 grew to Zł 1.4bn (+31% mom and +96% yoy) mainly due to one-off gains on sales of tangible assets while the increase in revenues (+10% mom) was offset by the seasonal growth in administrative costs (+8% mom) and provisioning (+33% mom). We think that strong increase of NII coupled with the significant decline in F&C revenues might have been driven by a change of bancassurance accounting policy by some banks (see [Polish Financial Weekly - Has PKO BP Changed Bancassurance Accounting in 4Q13?](#)).

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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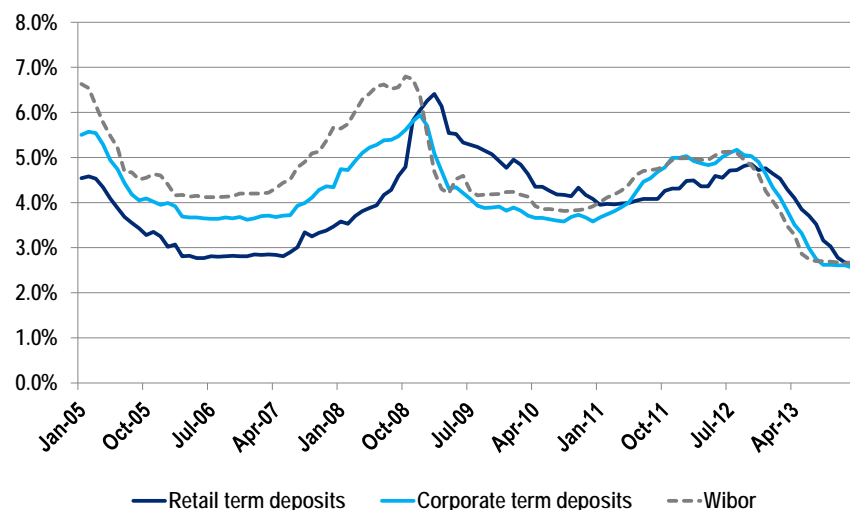
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In Our Opinion 2013 Was a Year of NIM Management and Usage of Accumulated Reserves

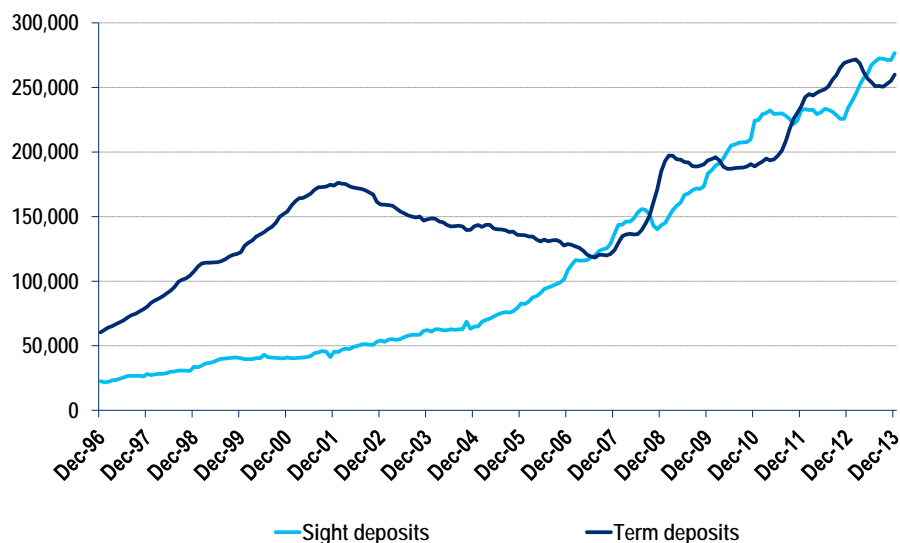
- **Deposit re-pricing** – The most successful strategy was to shorten maturity of funding through increasing share of corporate term deposits (on average shorter-term than retail deposits) or current and saving retail accounts (current account have usually interest rate close to zero, the rate on saving accounts is floating — we note however that the EU Payment Service Directive led to lengthening the process of saving account re-pricing). In 2013 the best in reducing cost of funding was Millennium followed by mBank, while the laggards, PKO BP (too late in cutting deposit rates) and Getin Noble Bank (having longer-term maturity of deposits) should benefit in 2014
- **Changes in asset mix** was driven by:
 - a gradual repayment of low-margin FX mortgages (see Fig. 25 and 27 for the sector trends) – the process may further accelerate in coming years due to an increased number of borrowers buying new flats and selling the old ones, funded by FX mortgages (for details see: [Polish Banks](#));
 - rising production of high-margin consumer loans (see Fig 30-31 for the sector trends) – given the rising competition both from universal banks (cross-selling consumer loans to own clients) and institutions specialized in consumer lending (benefiting from regulatory easing) the pace of growth may decelerate; the first signs of slowdown have been visible in the mBank, Millennium and ING BSK.
- **Usage of accumulated reserves**, e.g.: booking gains on bonds (e.g. ING BSK and Pekao), gains on subsidiaries (e.g. PKO BP's gain on selling stake in eService in 4Q14) and releasing of superfluous IBNR provisions.

Figure 1. Polish Banks – Interest Rate on Corporate and Retail Deposits, Jan05-Dec13 (Percentage)



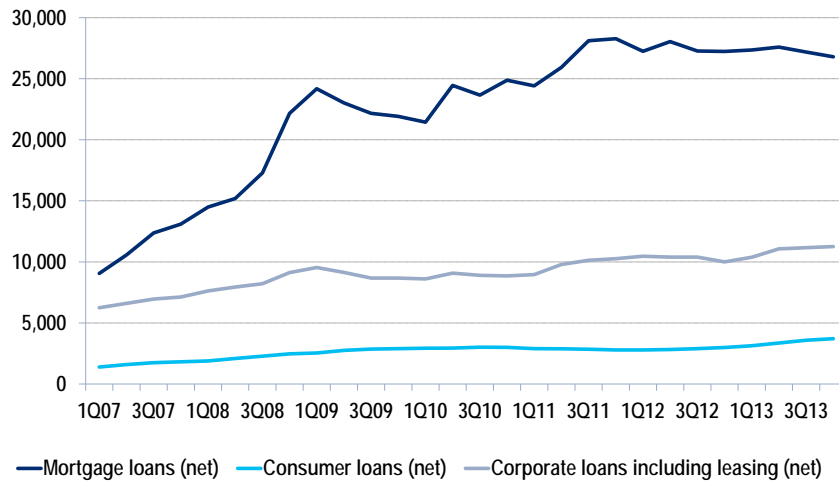
Source: NBP and Citi Research

Figure 2. Polish Banks – Retail Term vs. Sight Deposits, Dec 96-Dec13 (Polish Zloty in million)



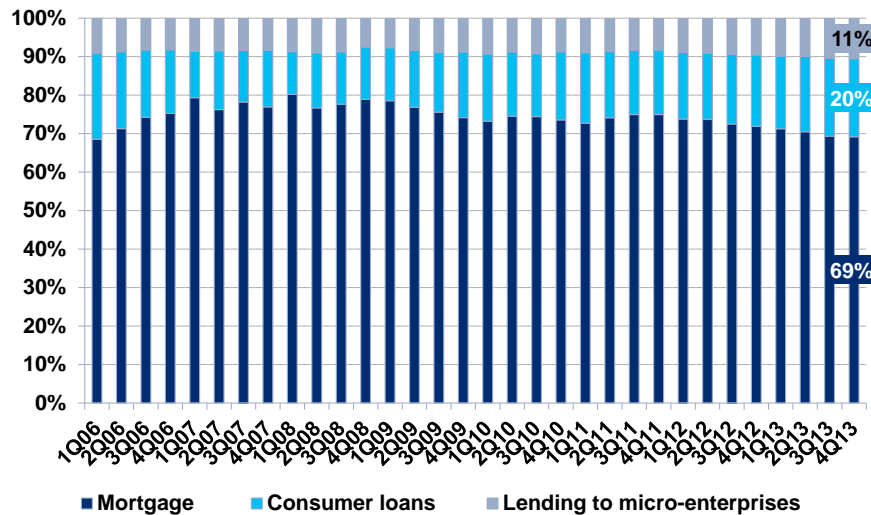
Source: NBP and Citi Research

Figure 3. Millennium – Structure of Loans, 1Q07-4Q14 (Polish Zloty in million)



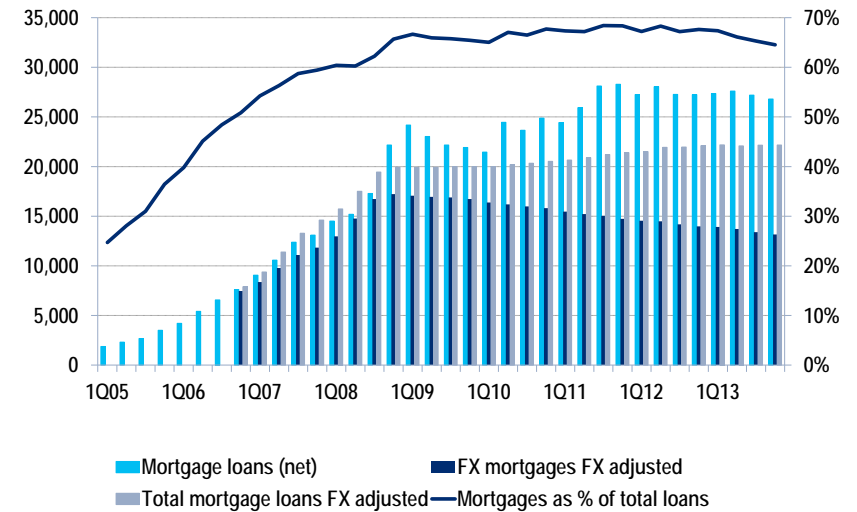
Source: Company reports and Citi Research

Figure 5. mBank – Structure of Retail Loans, 1Q06-4Q14 (Polish Zloty in million)



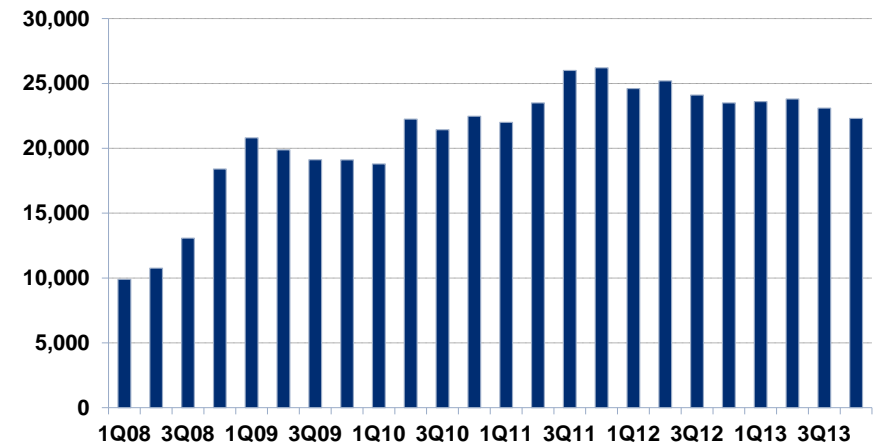
Source: Company reports and Citi Research

Figure 4. Millennium – Mortgage Loans, 1Q07-4Q14 (Polish Zloty in million)



Source: Company reports and Citi Research

Figure 6. mBank – FX Mortgage Loans, 1Q08-4Q14 (Polish Zloty in million)



Source: Company reports and Citi Research

We Think That 2014 and 2015 Will Be Years of Regulation and Recovery

■ Regulation, legislation and litigation risks, sometimes creating new business opportunities, e.g.:

- CRR/CRD 4 implementation is having a limited impact on capital ratios but in the longer term should force banks to increase the share of long-term funding, including mortgage-backed securities (the banks with mortgage bank subsidiaries, i.e. **mBank and Pekao, are better positioned than the rest**);
- lower interchange fee since July 2014 — only the banks with a rising number of active clients (e.g. **mBank and ING BSK**), are able to offset the lower fees by higher volumes;
- EU-wide asset quality review (AQR) and stress tests (the increased transparency should enable a better comparison of asset quality in different banks, but due to different business models, including different approaches to selling NPLs to companies specializing in debt collection, comparability will be limited);
- the potential implementation of a bank resolution regulation and a new contribution to the resolution fund (if based on RWAs or non-insured funding, it would less negatively impact earnings of banks with high ROA, including **PKO BP and Pekao**);
- the new KNF recommendation on bancassurance (see: [Polish Financial Weekly - Draft of Bancassurance Recommendation](#)), affecting the business model of consumer lending in the sector (the more innovative banks, which quickly find a new pricing model, should benefit);
- a risk of rising fines from UOKiK (the antimonopoly office) and legal claims from clients, suing banks regarding FX mortgages and multi-year investment products (**the most exposed to these risks is Getin Noble**, which was active in both sub-segments).

■ An increasing capital return to shareholders:

- **Millennium's and ING BSK's** management have announced their intention to pay dividends from 2013 earnings ,
- **mBank's** CEO has suggested the possibility of increasing the dividend payout to 75%,
- we see also a rising probability of an extraordinary dividend in **Pekao** in the medium term

■ An outperformance of “provincial banks” over “big city banks” driven by macro recovery when the difference between the strongest and the weakest region shrinks: due to client and branch network structure, **PKO BP and Getin Noble look better positioned than peers**;

■ Gradually rising revenues from investment products — banks haven't yet started to push the sales of investment funds to mass clients but we have seen signs of rising sales of third-party investment products (including investment funds and structured products) in Millennium and mBank's 2013 earnings.

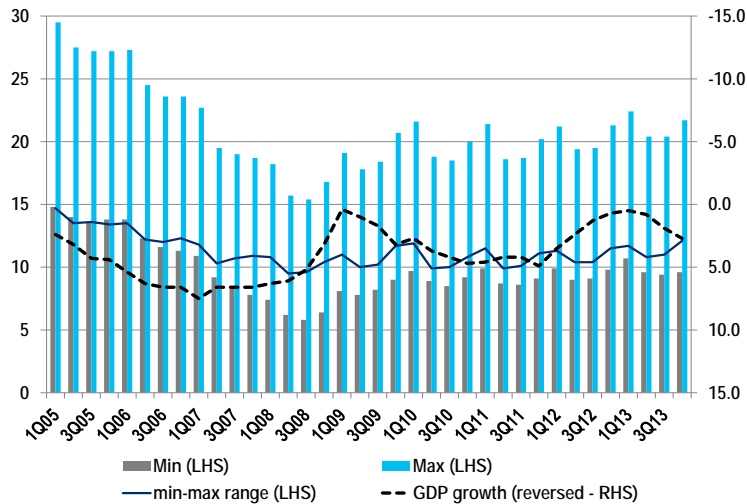
■ Deteriorating spreads, partially offsetting the positive impact of rising (starting in 2H14) interest rates — lower retail lending spreads are due to rising competition in consumer and mortgage lending, lower corporate lending spreads due to lower risk profile, and higher funding costs due to increased competition for deposits and rising share of longer-term funding

Figure 7. Polish Banks – Net Stable Funding Ratio, 3Q13 (Percentage)



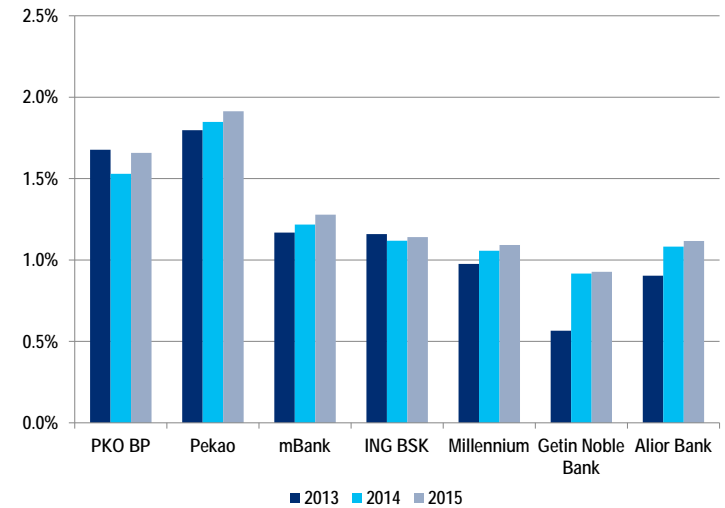
Source: Companies and Citi Research

Figure 9. Poland – Unemployment by Regions, 1Q05-4Q13 (Percentage)



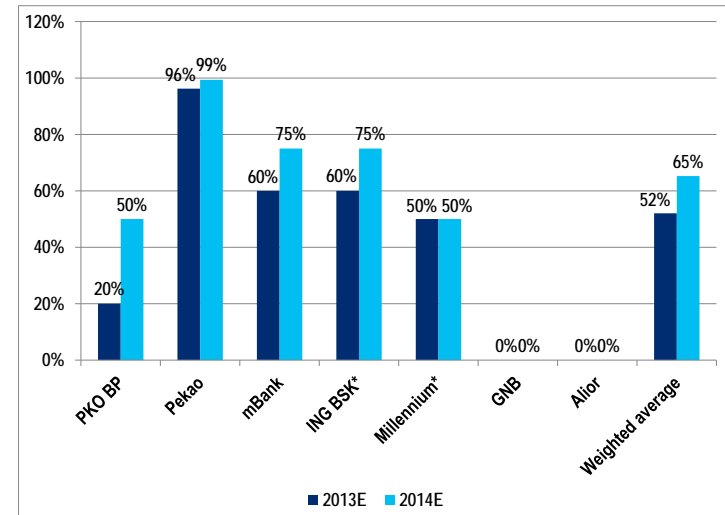
Source: GUS

Figure 8. Polish Banks – Return on Assets, 2013E-2015E (Percentage)



Source: Company reports and Citi Research

Figure 10. Polish Banks – Expected Dividend Payout Ratios, 2013E-2014E (Percentage)



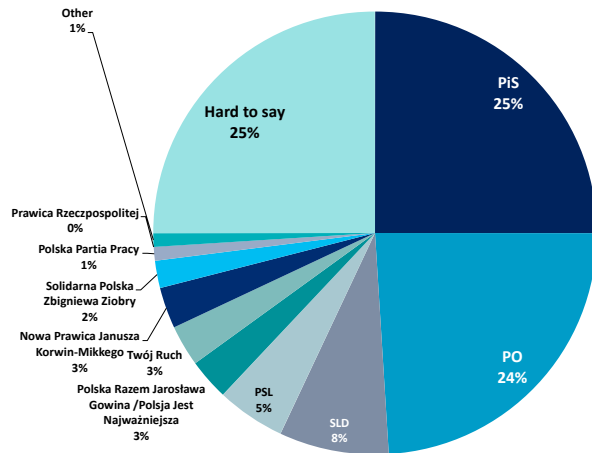
Note: * Bank management announcement of 2013 payout ratio

Source: Citi Research

What if PiS Wins the Parliamentary Election in 2015...?

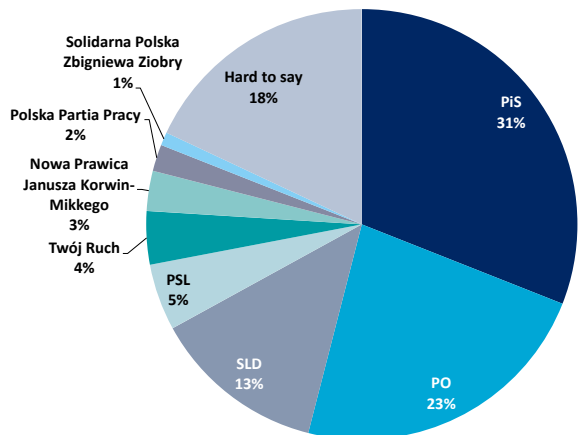
- **Prawo i Sprawiedliwość (PiS, Law and Justice), the right-wing political party led by Mr. Jarosław Kaczyński, has announced its new political agenda. It is focused on the three main themes — health, labour and family — but regarding the economy it includes several propositions that may impact the banks:**
 - PiS maintains its plan to raise ZŁ c.5bn annually from the new special tax on the financial sector (no details were disclosed but assuming 70% of that, proportional to the current participation of banks in financial sector earnings, comes from the banking sector, it would mean a c20-25% hit to sector net profits);
 - The party intends to stimulate investments and part of its ZŁ 1 trillion investment plan is a ZŁ 160-220bn program of bank loans for SMEs, funded through LTRO-like cheap funding from the central bank and credit risk covered by guarantees from the state-owned bank BGK.
 - According to the party's plan, the state would transfer state-owned land to special vehicles that will negotiate the terms of lending with banks, construct residential buildings and offer these flats to people who cannot afford to take a mortgage loan. PiS also intends to introduce building societies (we note that the left-wing SLD, strongly opposed by the central bank, has also proposed introduction of building societies in Poland).
 - PiS wants to back the Polish-owned banks, to support regaining control over foreign-owned banks by State-controlled institutions and assist the growth of small local financial institutions, including cooperative banks and credit unions.
- **PiS's proposed program should be studied with the interest but its significance shouldn't be overestimated:**
 - According to the latest polls, PiS continues to lead, with 25-31% of voters declaring their intention to support the party (the poll January and February by CBOS, TNS-Polaks and Homo Homini) but this support is still too low to achieve a majority in the new Parliament and thus it would likely have to look for a coalition partner. If PiS fails to convince PSL, currently the minor partner in the ruling coalition PO-PSL or SLD, being the successor of the communist party, then PO might be able to create a three-party coalition with PSL and SLD and stay in power despite the election defeat.
 - In the past Polish political parties, including both PiS and PO, have been pragmatic and when they have been in power they have tried to combine their short-term political interests with driving economic growth rather than implementing big, ideologically-driven programs.
- **In the next two years Poles will vote four times.**
 - The crucial vote will be parliamentary elections in **4Q15**.
 - Only slightly less important will be a presidential election (**3Q14**) as the president has veto power and plays an important role in appointing a new government, so the president's political position is relatively strong when the parliament majority is fragile.
 - The European Parliamentary election (**May 25, 2014**) will be the first test of the real support for political parties since the last parliamentary election in 2011. Parties failing in this election may try to regain support through changing their political program.
 - Local elections in **November 16, 2014** will be also a test for the real support of the main political parties, especially in big cities where the candidates for city presidents are usually affiliated with the major national parties

Figure 11. Poland – Support for Key Political Parties, January 2014 (Percentage)



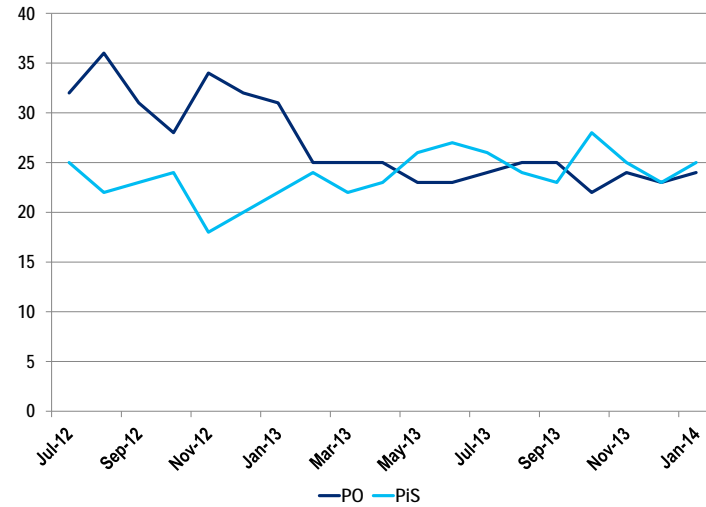
Note: 5% is the threshold for parties to get seats in Sejm, the lower chamber of Parliament
Source: CBOS

Figure 13. Poland – Support for Key Political Parties, January 2014 (Percentage)



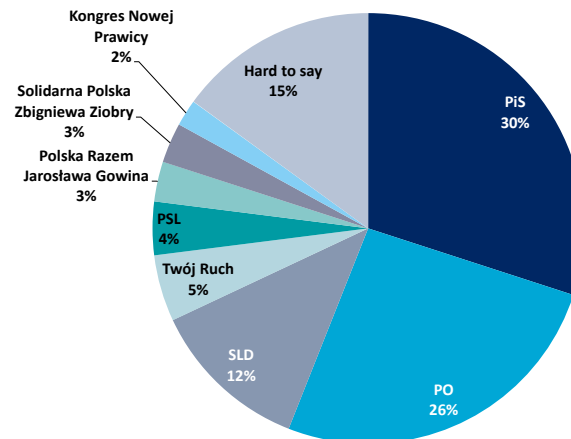
Source: IBRIS Homo Homini

Figure 12. Poland – Support for PiS and PO, Jul 12 – Jan 14 (Percentage)



Source: CBOS

Figure 14. Poland – Support for Key Political Parties, January 2014 (Percentage)

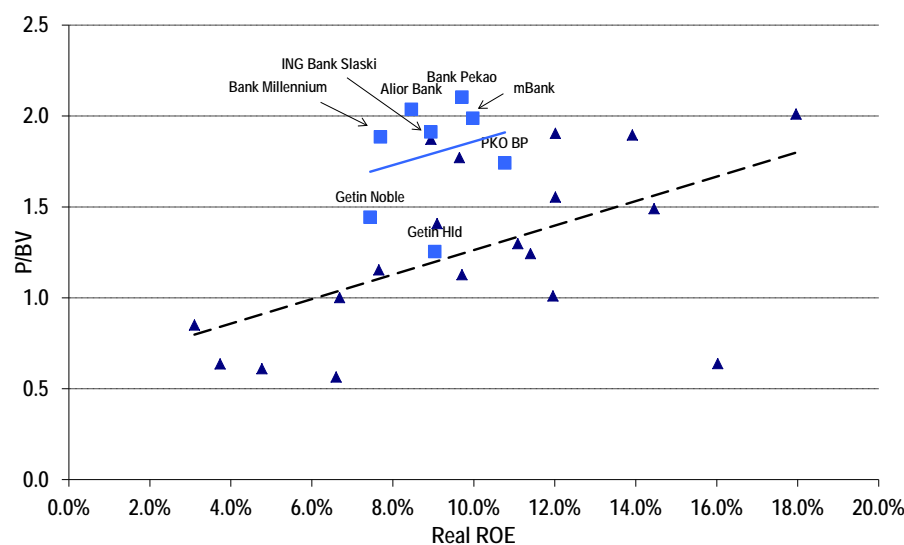


Source: TNS Polska

Ranking of Polish Financials

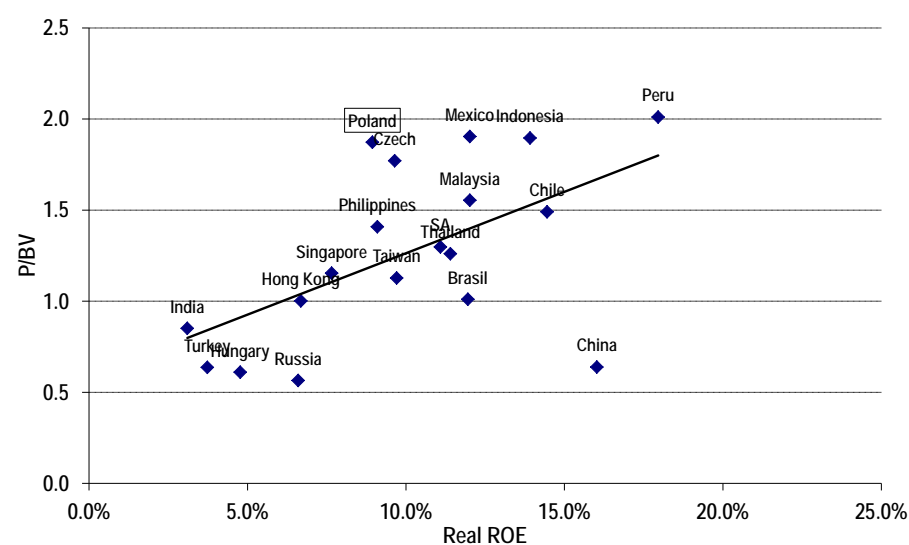
- Polish banks look expensive on our favored valuation method, i.e. on Weighted Equity Valuation based on return on tangible equity (ROTE) as well on traditional WEV based on return on equity. On our estimates, current market valuations imply that banks will reach and forever maintain the record high profitability achieved in 2006-07. We think this assumption is unrealistic. We believe in rising earnings in the next few years, not in perpetuity, hence we are still, despite the recent price declines, cautious on the sector's valuation (for details of our view on the sector see [Polish Banks - A Tale Of Two Halves: Long-Term Positives All In The Price For Now](#) and for recent forecasts: [Polish Banks - Lower-Than-Expected 2013 and 2014 Bank Levy and Long-Term Positives Look in the Price for Now](#); for a summary of bank top managements' expectations for 2014 see: [Polish Banks - New Year Postcard from Warsaw: Buy PKO BP](#)).
- Our Top Pick among Polish financials is the only Buy-rated bank, **PKO BP (TP ZI 47)** followed by the Neutral-Rated **Pekao (TP 182)** and the insurer **PZU (Neutral, TP ZL 447)**.

Figure 15. Polish Banks – P/BV and Real ROE*, 2015E



* At median, inflation adjusted Prices as of February 17, 2014.
Source: Citi Research estimates.

Figure 16. GEM Banks – P/BV and Real ROE*, 2015E



* At median, inflation adjusted Prices as of February 17, 2014.
Source: Citi Research estimates.

Valuation Table

Figure 17. CEEMEA Financials – Trading Multiples, 2012-2015E

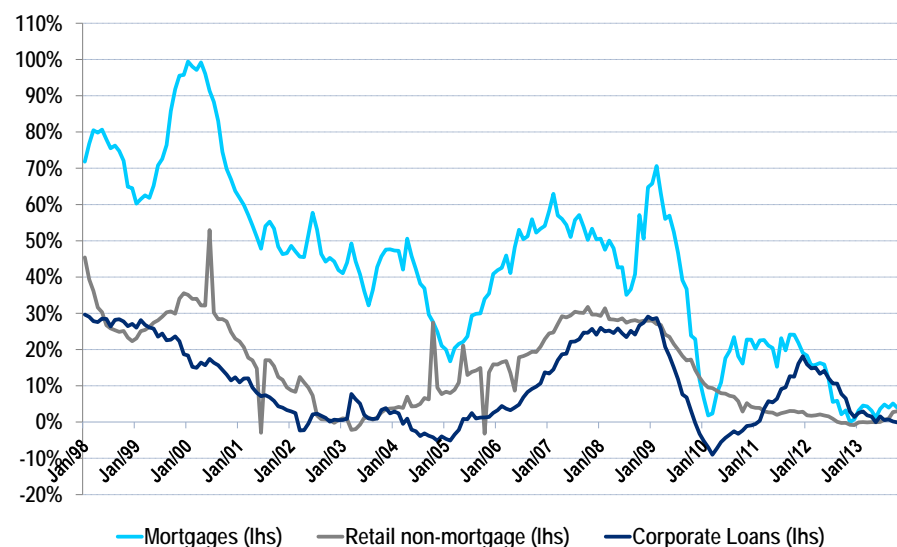
Company Name	Reuters Code	Share Price	Rating/Risk	Mkt Cap USD (M)	Free Float	Target price	Upside/Downside	ETR	P/E (x)				P/Adjusted BV (x)				Adjusted RoAE			
									2012	2013	2014	2015	2012	2013	2014	2015	2012	2013	2014	2015
Alior Bank	ALRR.WA	PLN 92.50	3H	2 139	59%	74.00	-20.00%	-20.00%	NM	29.87	22.55	18.03	3.04	2.82	2.26	2.04	3.38%	10.21%	11.96%	12.16%
Komerční Banka	BKOM.PR	CZK 4,688.00	2	8 905	40%	4 880.00	4.10%	9.00%	12.77	14.21	14.37	13.83	1.82	1.90	1.82	1.76	15.76%	13.08%	12.94%	12.94%
Getin Noble	GNB.WA	PLN 3.34	2H	2 926	44%	2.90	-13.17%	-13.17%	23.85	25.18	14.47	13.67	1.88	1.82	1.61	1.44	8.30%	7.33%	11.81%	11.14%
Getin Hld	GTN.WA	PLN 4.36	2H	1 054	44%	3.83	-12.16%	-12.16%	5.30	16.40	12.98	10.46	1.70	1.59	1.42	1.25	15.98%	10.02%	11.57%	12.74%
ING Bank Śląski	INGP.WA	PLN 134.50	3	5 784	25%	118.00	-12.27%	-8.19%	21.02	18.41	17.34	15.44	2.15	2.06	1.99	1.91	11.44%	11.43%	11.69%	12.64%
Intl Prsnl Fin	IPF.L	GBP 4.94	1	1 983	98%	7.00	41.70%	43.72%	18.42	13.16	12.39	9.60	3.30	3.23	2.64	2.21	19.74%	24.80%	23.03%	25.07%
mBank	MBK.WA	PLN 535.00	3	7 459	30%	505.00	-5.61%	-2.40%	18.73	18.70	17.01	14.87	2.35	2.21	2.08	1.99	13.71%	12.17%	12.60%	13.68%
Bank Millennium	MILP.WA	PLN 9.44	3	3 785	34%	5.60	-40.68%	-38.35%	24.25	21.37	18.58	17.04	2.37	2.14	2.00	1.88	10.04%	10.52%	11.13%	11.40%
OTP Bank	OTPB.BU	HUF 4,210.00	1	5 267	78%	5 135.00	21.97%	25.53%	9.21	9.85	6.93	6.06	0.74	0.71	0.66	0.61	8.33%	7.35%	9.81%	10.43%
Bank Pekao	PEO.WA	PLN 194.00	2	16 831	50%	182.00	-6.19%	-1.03%	17.23	18.79	17.53	15.80	2.18	2.16	2.13	2.10	13.24%	11.54%	12.24%	13.41%
PKO BP	PKO.WA	PLN 43.29	1	17 887	69%	47.00	8.57%	9.79%	14.44	16.25	15.55	12.55	2.19	2.12	1.90	1.74	15.77%	13.26%	12.89%	14.47%
PZU	PZU.WA	PLN 443.60	2	12 662	65%	447.00	0.77%	7.53%	12.57	12.15	13.39	14.15	2.70	2.91	2.85	2.97	22.60%	23.05%	21.52%	20.56%
Central Europe Banks Agg					99 487		-1.55%	2.09%	15.62	16.32	14.93	13.35	2.11	2.03	1.91	1.81	15.04%	13.46%	13.90%	14.68%
Erste Bank	ERST.VI	EUR 28.50	2	16 772	65%	25.00	-12.28%	-10.18%	32.60	NM	12.11	9.89	1.01	1.09	1.03	0.96	3.21%	0.66%	8.72%	10.04%
Raiffeisen Bank Intl	RBIV.VI	EUR 28.50	3	11 433	48%	26.80	-5.96%	-2.98%	10.61	17.11	10.60	8.06	0.73	0.75	0.78	0.73	7.03%	4.32%	8.69%	9.36%
Austria Banks Agg					28 205		-9.72%	-7.26%	17.71	36.44	11.45	9.06	0.87	0.92	0.91	0.85	4.68%	2.12%	8.69%	9.76%
Bank of Georgia	BGEO.L	GBP 21.66	2	1 231	83%	24.50	13.11%	15.61%	12.10	10.62	9.28	7.58	2.06	1.80	1.61	1.38	19.82%	19.76%	18.98%	19.95%
Bank St Petersburg	BSBP.MM	RUB 38.59	1	483	53%	57.00	47.71%	47.99%	27.22	4.63	3.63	3.07	0.29	0.36	0.33	0.30	1.30%	7.70%	9.48%	10.18%
Halyk Bank	HSBKq.L	USD 9.10	2	2 481	100%	9.30	2.20%	6.13%	6.81	6.06	7.83	7.08	1.18	1.01	1.07	0.94	22.92%	20.78%	15.29%	16.07%
Kazkommertsbank	KKGBYq.L	USD 1.85	2H	720	100%	1.80	-2.70%	-2.70%	-0.82	4.08	4.77	3.38	0.41	0.38	0.42	0.37	-41.00%	9.66%	8.33%	11.60%
Sberbank	SBER.MM	RUB 96.65	1	61 653	51%	148.00	53.13%	56.09%	6.03	5.80	5.25	4.76	1.30	1.09	0.93	0.80	24.15%	20.45%	19.11%	18.08%
Bank VTB	VTBRq.L	USD 2.57	1	16 516	39%	3.20	24.42%	26.40%	5.53	8.46	5.83	5.02	0.68	0.68	0.62	0.56	13.28%	8.05%	10.81%	11.68%
Bank Vozrozhdenie	VZRZ.MM	RUB 446.00	1	302	44%	583.00	30.72%	30.83%	4.55	8.73	4.65	3.53	0.51	0.48	0.44	0.39	11.87%	5.67%	9.85%	11.66%
CIS Banks Agg					86 566		43.34%	45.97%	6.44	6.22	5.42	4.84	1.06	0.95	0.83	0.73	21.29%	17.67%	16.75%	16.66%
Alpha Bank	ACBr.AT	EUR 0.70	2	10 454	42%	NA	NA	-0.34	1.82	-11.16	NM	-1.14	1.18	1.32	1.35	-1444.12%	71.60%	-11.19%	1.18%	
Piraeus Bank	BOPr.AT	EUR 1.93	2	13 405	19%	NA	NA	-4.41	2.96	-10.31	NM	-0.69	1.17	1.32	1.31	NA	127.77%	-12.02%	0.91%	
National Bank of Greece	NBGr.AT	EUR 3.70	2	12 143	16%	NA	NA	-1.91	NM	NM	16.55	-0.91	1.57	1.54	1.41	-346.22%	-10.38%	1.77%	8.88%	
Greece Banks Agg					36 002		NA	NA	-0.90	3.57	-17.15	39.19	-0.86	1.28	1.39	1.35	-891.18%	61.80%	-7.11%	3.68%
Bank Asya	ASYAB.IS	TRY 1.22	1	503	76%	2.45	100.82%	100.82%	6.10	5.11	4.23	3.13	0.45	0.41	0.37	0.33	7.68%	8.39%	9.17%	11.11%
Garanti	GARAN.IS	TRY 6.41	1	12 344	51%	7.43	15.91%	18.56%	8.07	7.96	9.38	6.10	1.25	1.17	1.09	0.96	16.97%	15.18%	12.01%	16.68%
Halkbank	HALKB.IS	TRY 11.80	1	6 763	49%	18.25	54.66%	58.05%	5.58	5.42	6.84	5.23	1.28	1.12	0.98	0.85	26.36%	22.01%	15.29%	17.42%
Isbank	ISCTR.IS	TRY 4.31	1	8 892	31%	6.10	41.53%	45.24%	5.68	5.51	5.74	5.25	0.88	0.80	0.70	0.63	17.14%	15.24%	13.05%	12.63%
Vakıfbank	VAKBN.IS	TRY 3.57	1	4 092	42%	4.95	38.66%	40.34%	5.77	5.11	5.47	4.35	0.82	0.75	0.64	0.55	15.40%	15.39%	12.67%	13.69%
Yapi Kredi	YKBK.IS	TRY 3.46	1	6 896	18%	4.85	40.17%	42.20%	7.20	6.58	6.35	5.26	0.94	0.86	0.76	0.67	14.63%	13.64%	12.67%	13.49%
Turkey Banks Agg					39 490		35.99%	38.77%	6.52	6.21	6.80	5.32	1.02	0.93	0.83	0.73	18.20%	16.51%	12.83%	14.96%
African Bank	ABLJ.J	ZAR 9.37	1	1 296	90%	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
ABSA Grp	BGAJ.J	ZAR 130.30	2	10 180	45%	141.00	8.21%	14.88%	10.61	9.33	8.17	7.16	1.43	1.33	1.22	1.12	14.96%	14.78%	15.69%	16.42%
FirstRand	FSRJ.J	ZAR 31.80	1	16 522	66%	37.90	19.18%	24.18%	12.78	10.81	9.30	8.07	2.60	2.29	2.01	1.78	21.49%	22.51%	23.02%	23.41%
Investec	INVP.L	GBP 4.26	1	6 360	88%	5.30	24.44%	28.67%	12.88	12.28	10.79	9.32	1.14	1.10	1.04	0.99	8.97%	9.37%	10.18%	11.17%
Nedbank Ltd	NEDJ.J	ZAR 197.00	2	9 264	47%	213.00	8.12%	13.11%	12.39	10.95	9.55	8.29	1.68	1.55	1.42	1.30	14.59%	15.20%	16.00%	16.84%
South Africa Banks Agg					61 360		11.51%	16.59%	12.32	10.82	9.39	8.14	1.71	1.56	1.42	1.30	15.86%	15.80%	16.58%	17.57%
Attijariwafa Bnk	ATW.CS	MAD 305.90	1	7 610	18%	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
CIB	COMI.CA	EGP 34.66	2H	4 482	90%	25.33	-26.91%	-24.16%	14.16	11.05	8.45	7.03	2.87	2.42	2.01	1.73	22.76%	24.14%	26.41%	26.91%
MENA Banks Agg					12 093		-26.91%	-24.16%	14.16	11.05	8.45	7.03	2.87	2.42	2.01	1.73	23.28%	23.42%	26.39%	26.91%
Zenith Bank	ZENITHB.LG	NGN 20.10	1	3 885	91%	29.00	44.28%	52.69%	6.30	6.90	5.36	4.54	1.37	1.27	1.15	1.02	23.53%	19.11%	22.43%	23.72%
Rest of Africa Banks Agg					3 885		44.28%	52.69%	6.30	6.90	5.36	4.54	1.37	1.27	1.15	1.02	23.55%	18.98%	22.29%	23.72%

Source: Powered by dataCentral (Prices as February 14, 2013).

Sector Loan-to-Deposits Ratio Decreased to 105%

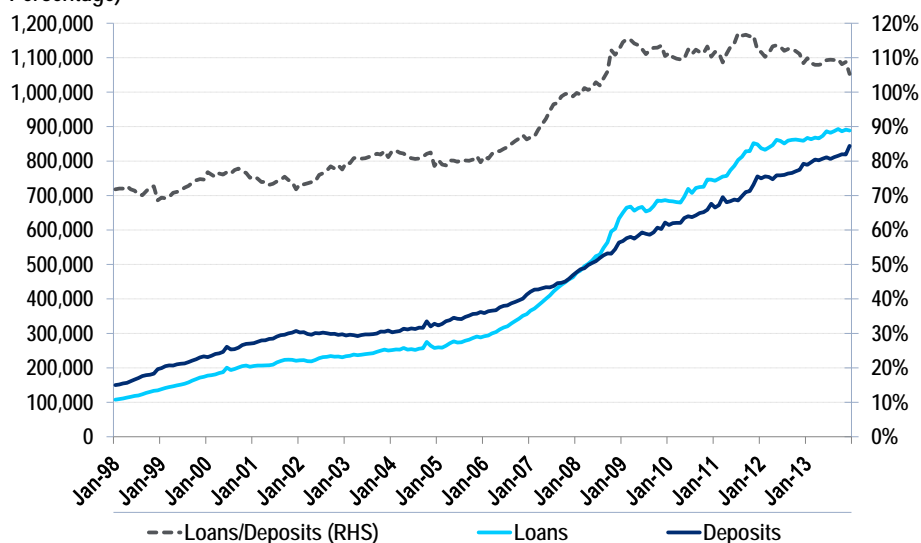
- Volume trends in December 2013 were affected by the appreciation of the Polish Zloty, which rose +2.35% in December vs. USD, +0.79% vs. CHF and +1.25% vs. EUR.
- Mortgage loans increased +4.6% yoy, but FX-adjusted growth was +6.6% yoy (+6.5% in November 2013). Corporate loans grew 0.8% yoy (vs. 0.5% yoy in November) and non-mortgage retail loans increased 3.9% yoy (vs. 3.4% yoy in the previous month).
- In December 2013 retail deposits increased +6.4% yoy (vs. 6.4% yoy in November) while corporate deposits grew by +9.6% yoy (vs. +7.4% yoy in the previous month). Assets under management (AUM) of investment funds rose to ZI 189.0bn in December 2013 from ZI 182.9bn in November and the annual growth rate decreased to +29.6% from +30.1% yoy in the previous month. According to our estimates, monthly net AUM flows in December 2013 amounted to ZI +6.8bn (vs. ZI 4.3bn in November 2013), driven by ZI 5.9bn inflows to one dedicated fund (vs. ZI 1.2bn outflows in November 2013).
- In December 2013, loans decreased 0.3% mom while deposits grew by 3.0% mom and the sector loan-to-deposit ratio decreased to 105.3% from 108.8% in November 2013 (vs. 108.4% in December 2012).

Figure 18. Polish Banks — Polish Banks – Loan Growth yoy, Jan98-Dec13 (Percentage)



Source: NBP, Citi Research

Figure 19. Polish Banks — Loans and Deposits, Jan 98-Dec13 (Polish Zloty in millions, Percentage)

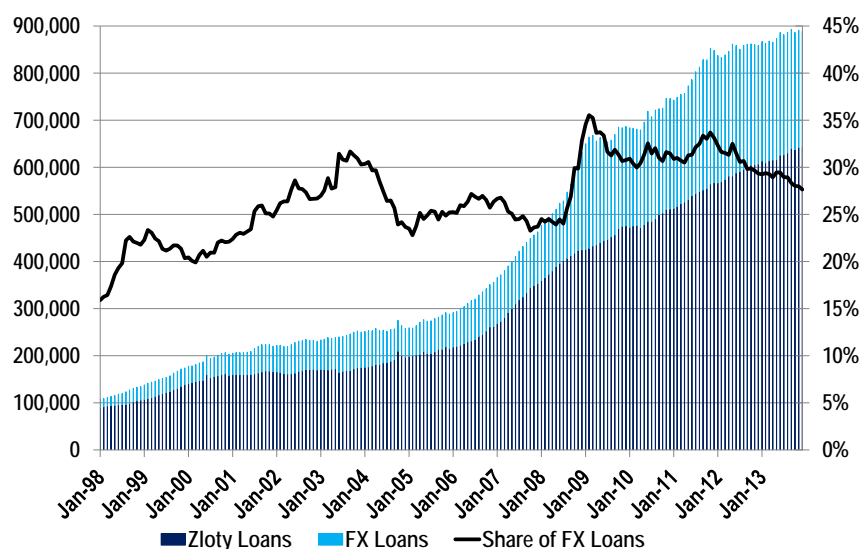


Source: NBP, Citi Research

Share of FX Lending at 28% of Total Sector Loans

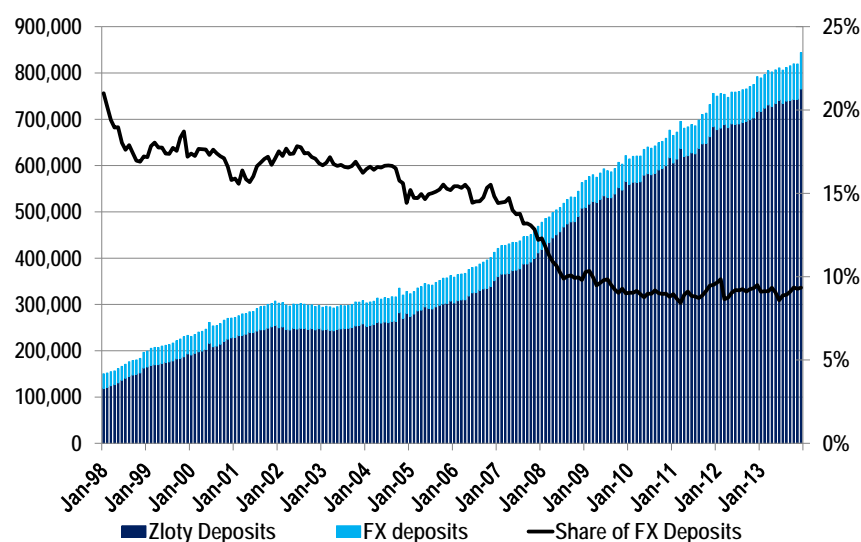
- The share of FX lending in total sector loans in December 2013 was flat at 28% (vs. 28% in November 2013 and 29% in December 2012).
- FX deposits amounted to 9.3% of total deposits (flat vs. November 2013 and down vs. 9.5% in December 2012).

Figure 20. Polish Banks — FX Structure of Loans, Jan98-Dec13 (Polish Zloty in millions, Percentage)



Source: NBP, Citi Research

Figure 21. Polish Banks — FX Structure of Deposits, Jan98-Dec13 (Polish Zloty in millions, Percentage)

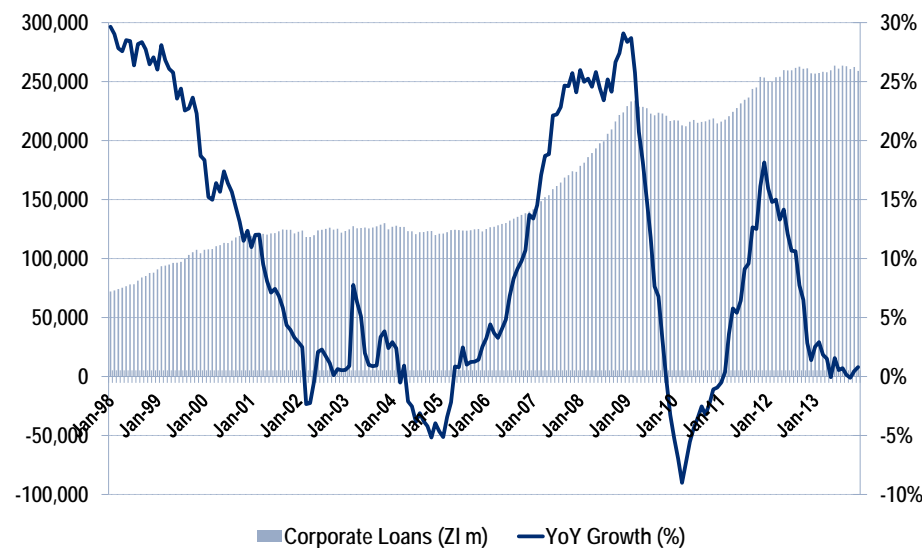


Source: NBP, Citi Research

Corporate Loans Decreased in December

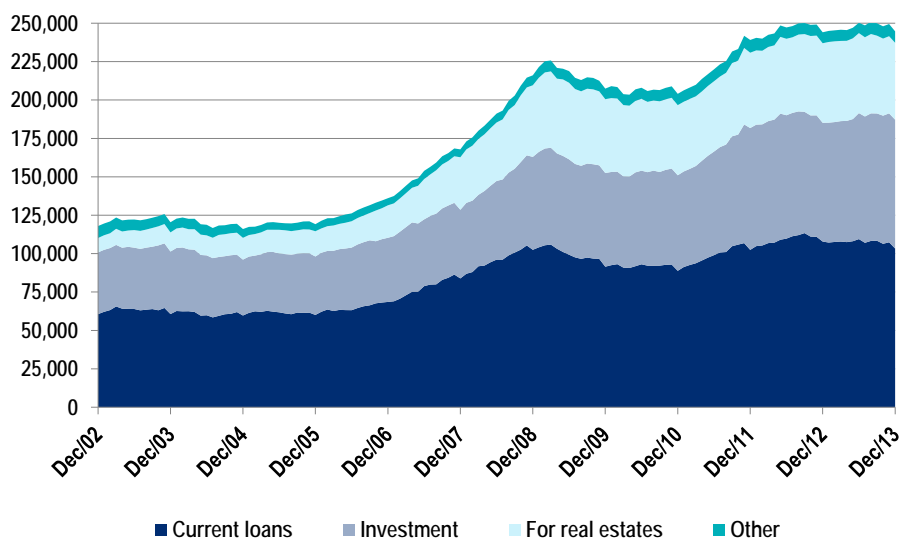
- Total corporate loans (plus other corporate receivables) of Polish banks reached ZI 259.0bn in December 2013 (+0.8% yoy and -1.3% mom vs. +0.5% yoy and +0.7% mom in November 2013). The monthly net decrease was ZI -3.3bn (vs. ZI +1.8bn in November 2013 and ZI -4.2bn in December 2012). The cumulative 12-month change was +2.1bn (vs. +1.2bn in November 2013).
- The yoy increase in lending was driven by growing investment loans (+8.5% yoy vs. +6.2% yoy in November) and other loans (+4.2% yoy vs. +9.9% yoy, respectively), while working capital and real estate loans declined -4.2% yoy (vs. -3.2% yoy in November) and -3.3% yoy (vs. -3.3% yoy), respectively.

Figure 22. Polish Banks — Volume and Growth of Corporate Loans, Jan98–Dec13 (Polish Zloty in millions, Percentage)



Source: NBP, Citi Research

Figure 23. Polish Banks — Corporate Loan Structure, Dec02–Dec13 (Polish Zloty in millions)

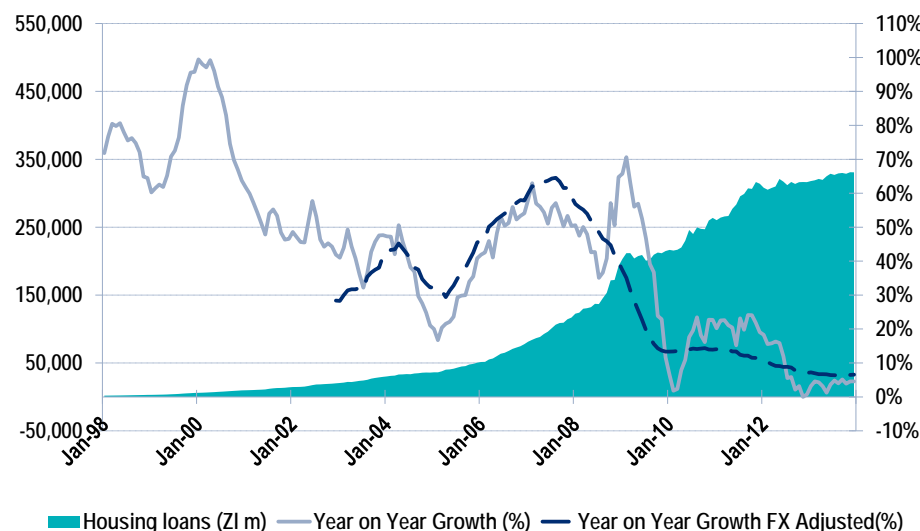


Source: NBP, Citi Research

Record-High Mortgage Loan Availability

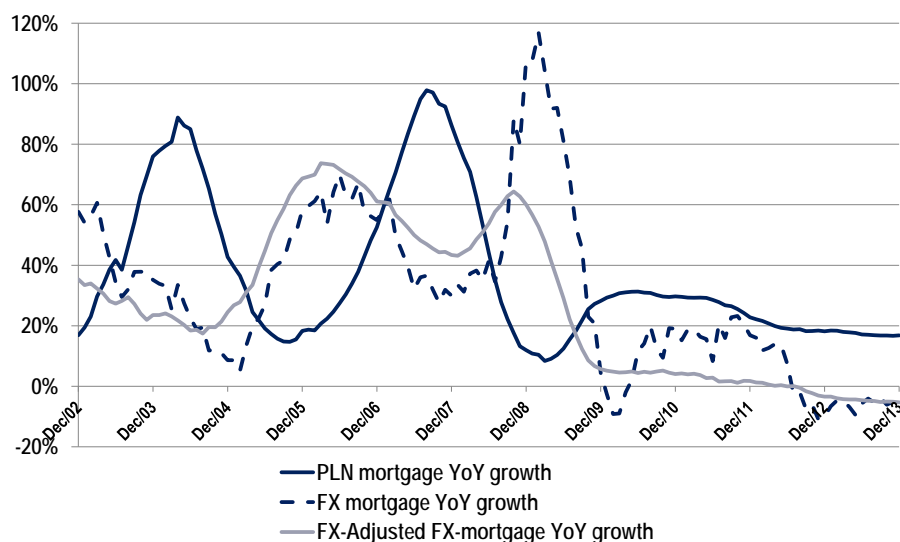
- In December 2013 mortgage loans was flat at ZI 330.8bn (+0.0% mom, +4.6% yoy, FX-adjusted change +0.5% mom and +6.6% yoy). According to our estimates, FX-adjusted mortgage volumes grew by ZI 1.4bn in December 2013 vs. ZI 1.3bn in November 2013 and ZI 1.0bn in December 2012. Cumulative 12-month, FX-adjusted growth was ZI 13.9bn (vs. ZI 13.5bn in November 2013 and ZI 15.6bn in December 2012).
- In January 2014 the Mortgage Availability Index calculated by Open Finance and TVN BiS increased 3.60 point mom and grew 4.97 points yoy to reach 126.65 points – a new record-high value for the third time in a row. We note that the index is calculated on the basis of average salary in the previous month, making it sensitive to mom changes in average salary.

Figure 24. Polish Banks — Volume and Growth of Mortgage Loans, Jan 98-Dec13 (Polish Zloty in million, Percentage)



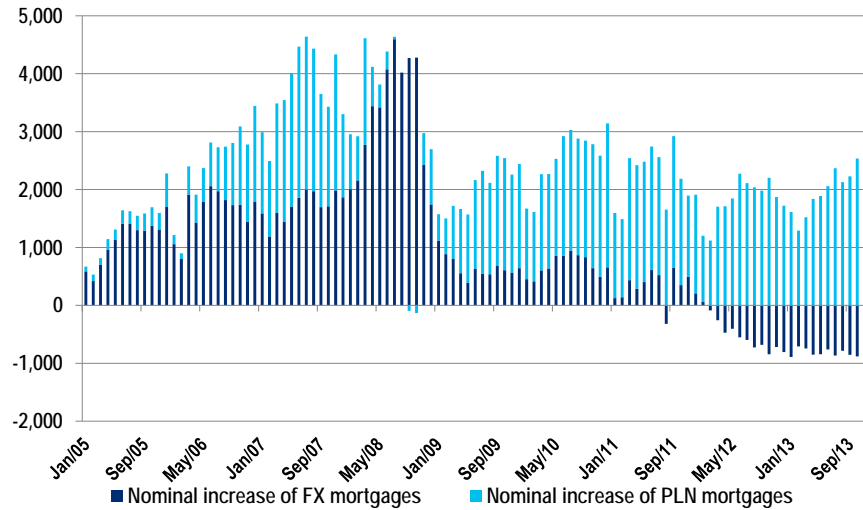
Source: NBP, Citi Research

Figure 25. Polish Banks — Mortgage YoY growth, Dec02-Dec13 (Percentage)



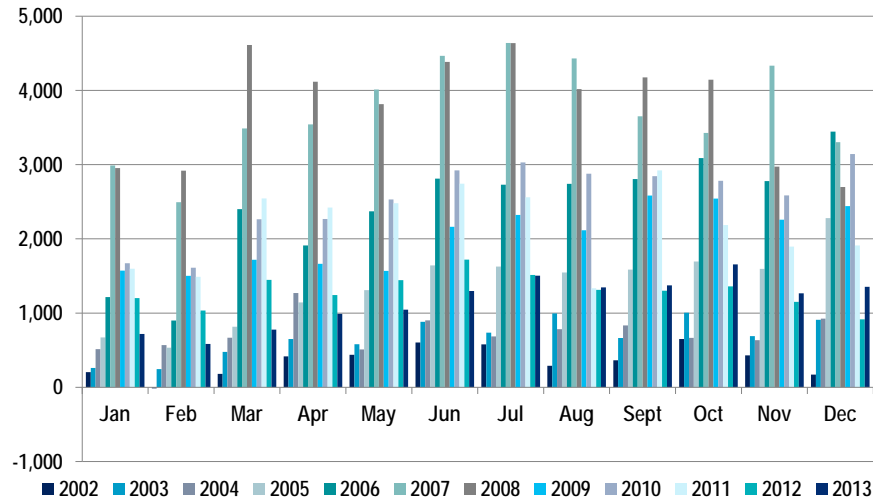
Source: NBP, Citi Research

Figure 26. Polish Banks — Currency Split of Mortgage Loan Additions, Jan06-Dec13 (Zloty in m)



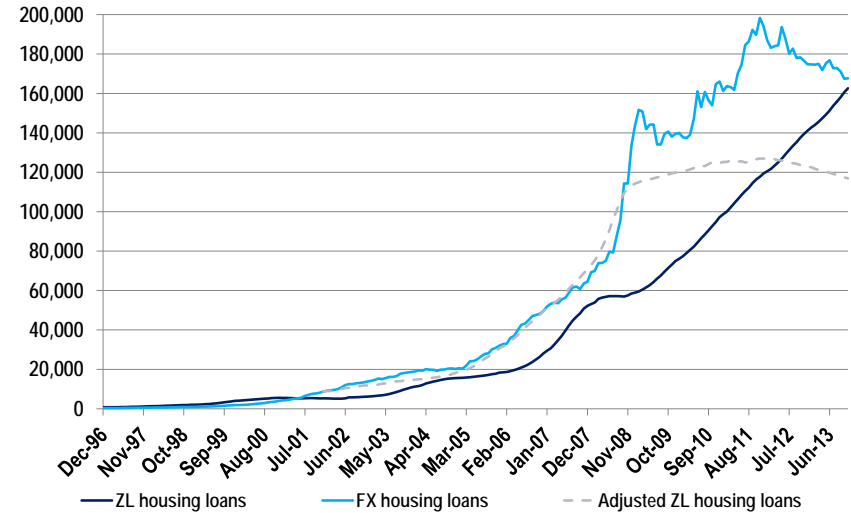
Source: NBP, Citi Research

Figure 28. Polish Banks — FX-Adjusted Monthly Growth of Mortgage Loans, Jan04-Dec13 (Polish Zloty in millions)



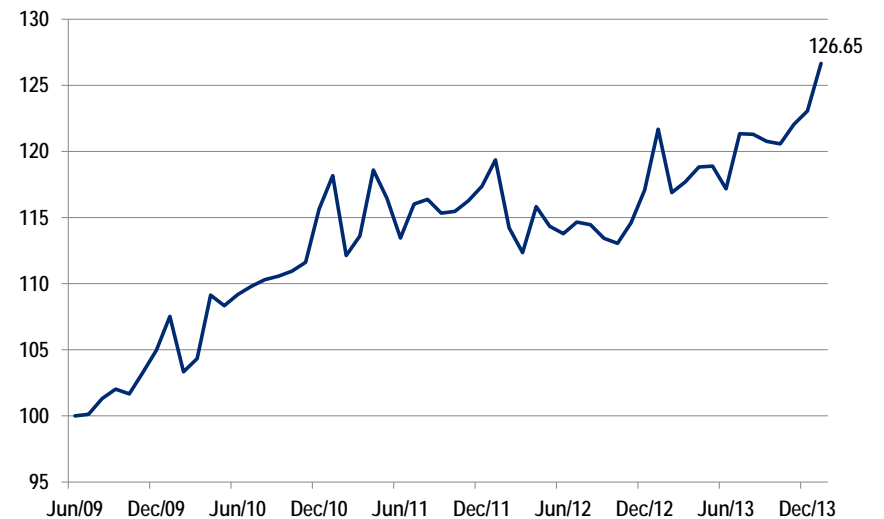
Source: NBP, Citi Research

Figure 27. Polish Banks — Currency Split of Mortgage Stock, Dec96-Dec13 (Polish Zloty in m)



Source: NBP, Citi Research

Figure 29. Mortgage Availability Index of Open Finance and TVN CNBC, Jan09-Jan13 (Points)

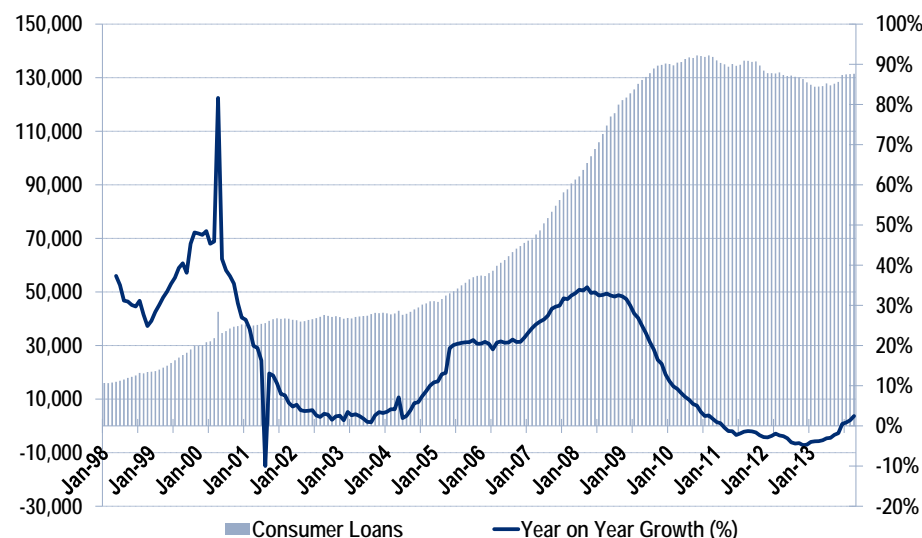


Source: Open Finance, TVN BiS

Consumer Loans in Positive Trend

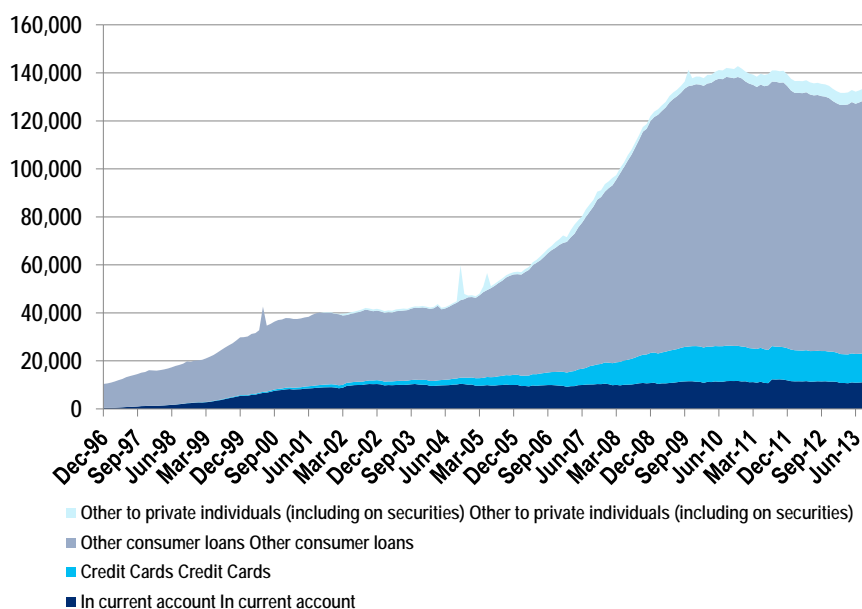
- In December 2013 non-mortgage retail loans (i.e. consumer loans and loans to individual entrepreneurs and farmers) fell by 0.3% mom and reached ZI 216.3bn. The annual growth rate was +3.9% yoy vs. +3.4% yoy in the previous month.
- Consumer loans increased +0.1% mom in December 2013 (vs. +0.1% mom in November) and reached ZI 131.4bn. We note that the growth rate of consumer lending continued its positive trend increasing 2.5% yoy in December 2013 (vs. +1.4% yoy in November and -4.6% yoy in December 2012).
- In December 2013 other consumer loans was flat, 0.0% mom (vs. +0.2% mom in November and -1.1% mom, in December 2012), while current account loans decreased -0.2% mom (vs. -0.8% mom in November 2013 and +0.1% in December 2012) and credit card loans grew by 1.3% mom (vs. -0.4% mom in November 2013 and -0.2% mom in December 2012).

Figure 30. Polish Banks — Volume and Growth of Non-Mortgage Retail Loans, Jan98–Dec13 (Polish Zloty in millions)



Source: NBP, Citi Research

Figure 31. Polish Banks — Non-Mortgage Loans to Private Individuals, Dec96-Dec13 (Polish Zloty in millions)

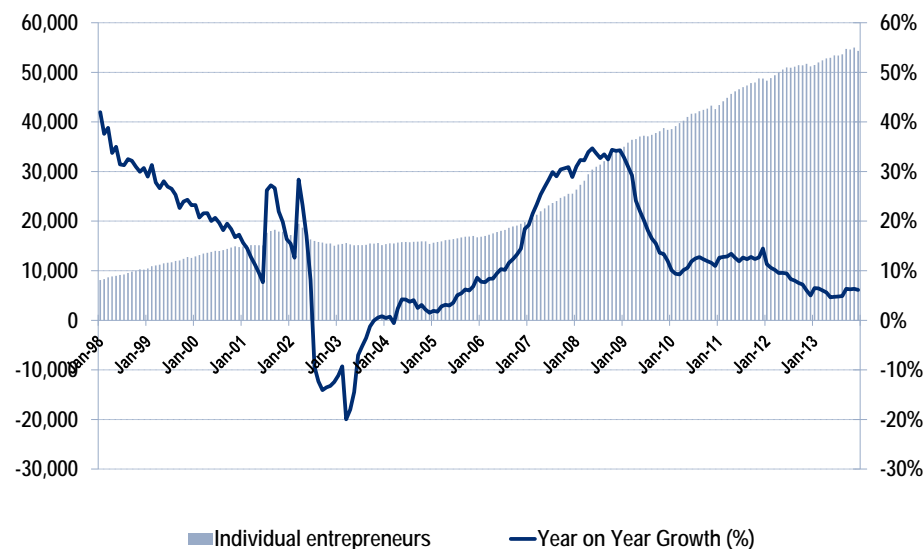


Source: NBP, Citi Research

Lower Dynamics in Loans to Individual Entrepreneurs

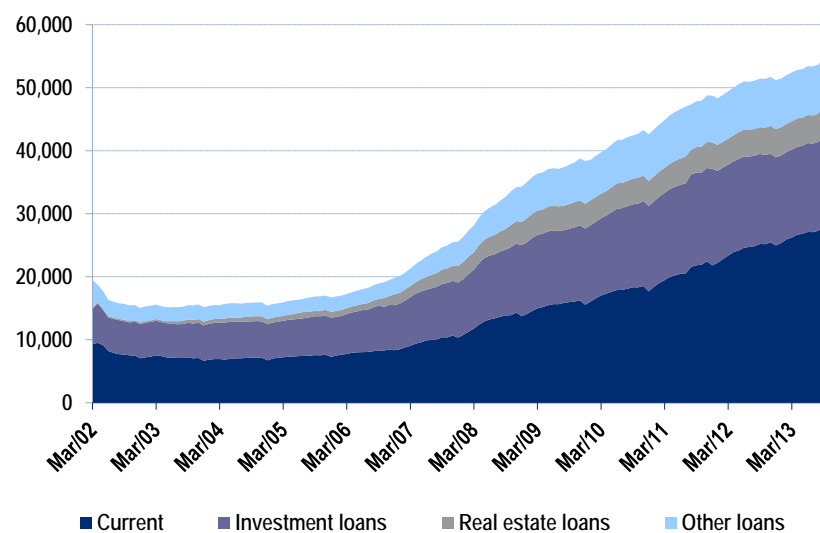
- Total loans to individual entrepreneurs decreased slightly in December 2013 to ZI 54.3bn (+6.1% yoy and -1.2% mom vs. +6.3% yoy and +0.7% mom in November). The monthly net decrease reached ZI 0.7bn (vs. ZI +0.4bn in November 2013 and ZI -0.5bn in December 2012).
- In December 2013 current account loans to individual entrepreneurs dropped by 2.4% mom (ZI -688m), real estate loans was broadly flat mom (ZI +2m) and investment loans increased +0.3% mom (ZI 45m) while other loans decreased slightly by 0.1% mom (ZI -9m).

Figure 32. Polish Banks — Volume and Growth of Loans to Individual Entrepreneurs Jan 98-Dec13 (Polish Zloty in millions)



Source: NBP, Citi Research

Figure 33. Polish Banks — Structure of Loans to Individual Entrepreneurs, Mar02-Dec13 (Polish Zloty in millions)

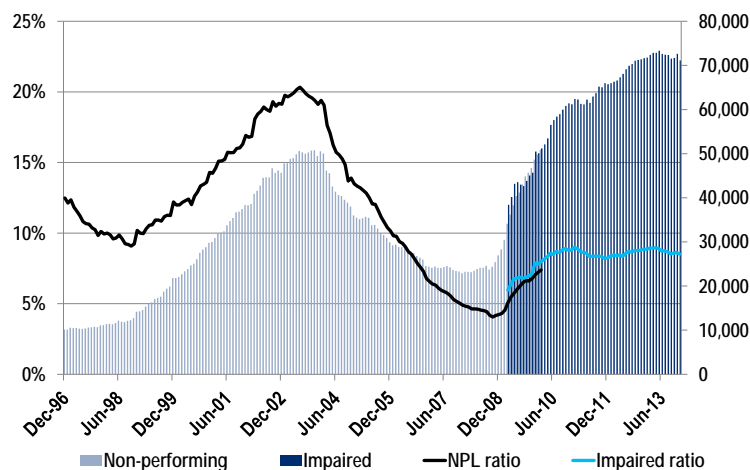


Source: NBP, Citi Research

Asset Quality – Growth of Corporate Coverage Ratio

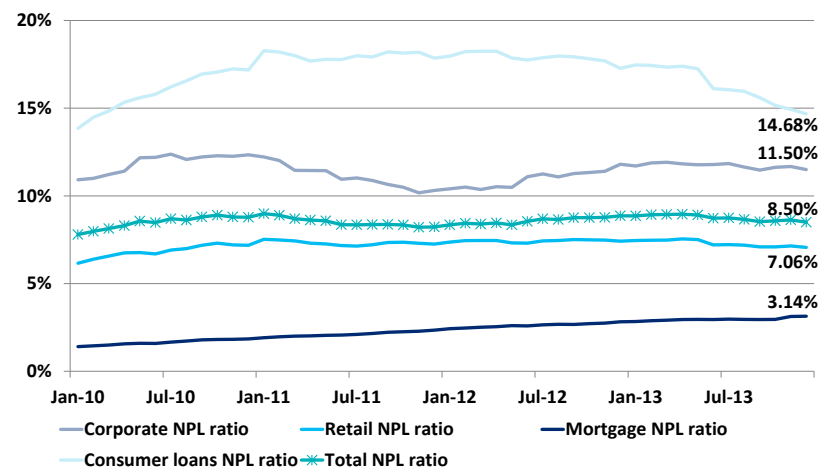
- In December 2013 the sector NPL ratio (impaired loans-to-total-loans) decreased to 8.50% from 8.63% in the previous month.
- In December the NPL ratio of FX-denominated corporate loans increased to 6.7% from 6.5% in November while the ratio for Zloty-denominated loans fell to 13.1% vs. 13.4% in previous month. As a result, the total corporate NPL ratio was 11.5% (vs. 11.7% in November 2013 and 11.8% in December 2012).
- The NPL ratio of Zloty-denominated mortgages slightly decreased to 3.96% from 3.99% in November while the NPL ratio of Swiss franc-denominated mortgages increased to 2.62% from 2.58% in the previous month. The NPL ratio of other FX-denominated mortgage loans was flat at 1.01% and the total mortgage NPL ratio increased to 3.14% from 3.13% in November 2013 and 2.82% in December 2012.
- The consumer NPL ratio declined to 14.68% from 14.93% in November 2013 and 17.27% in December 2012.
- The coverage ratio of impaired loans to non-financial entities grew to 55.0% in December from 54.5% in November 2013 and 54.2% in December 2012 driven by an increase in coverage ratio of corporate loans to 45.4% in December from 44.8% in November 2013 and 40.7% in December 2012.

Figure 34. Polish Banks — Volume of Impaired Loans and NPL Ratio, Dec96 - Dec13 (Percentage, Polish Zloty in billions)



Source: NBP, Citi Research

Figure 35. Polish Banks — NPL Ratio, Mar09 - Dec13 (Percentage)



Source: NBP, Citi Research

Figure 36. Polish Banks — Volume of Impaired Corporate Loans and Corporate NPL Ratio, Feb95 - Dec13 (Percentage, Polish Zloty in billions)

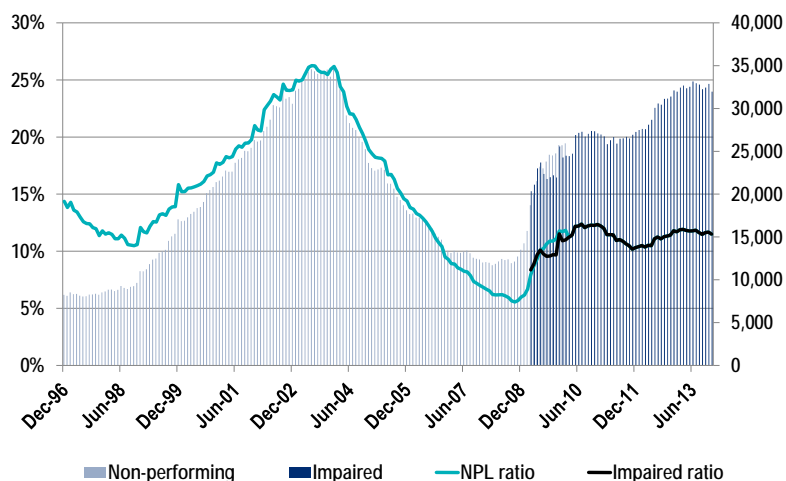
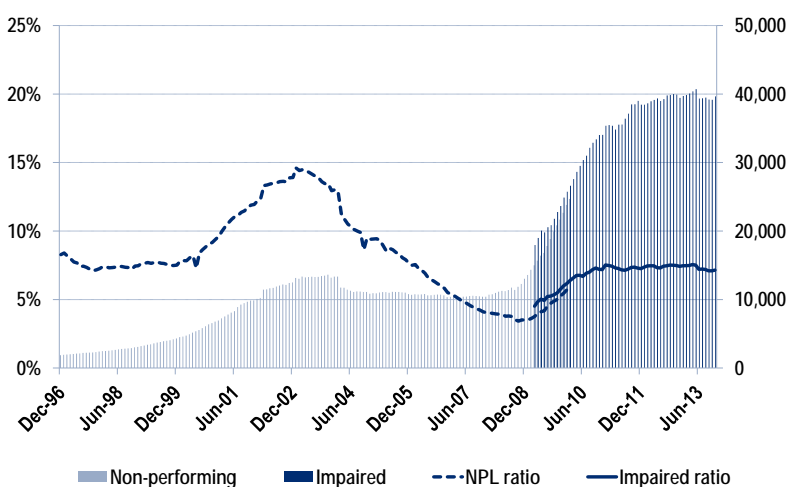


Figure 38. Polish Banks — Volume of Impaired Retail Loans and Retail NPL Ratio, Dec 96 - Dec13 (Percentage, Polish Zloty in billions)



Source for all: NBP, Citi Research

Figure 37. Corporate NPL Volumes and NPL ratio, Mar09 - Dec13 (Polish Zloty in billion, Percentage)

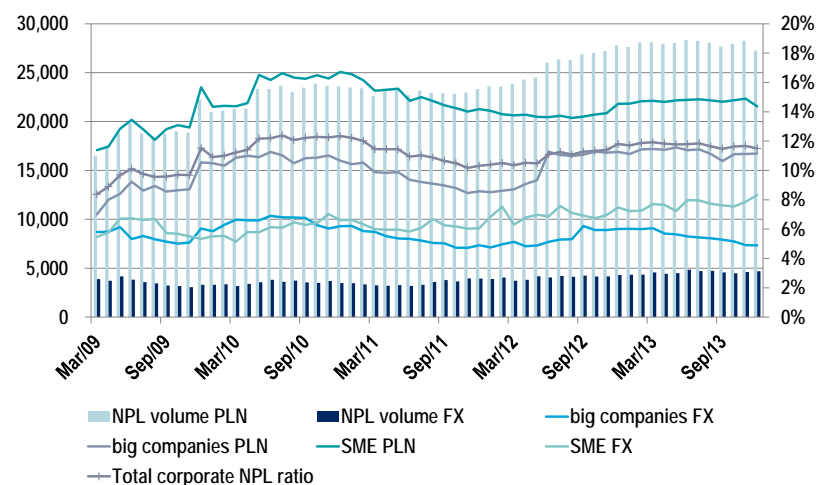


Figure 39. Polish Banks — Mortgage NPL Volumes and NPL ratios, Mar 2009 - Dec13 (Polish Zloty in billion, Percentage)

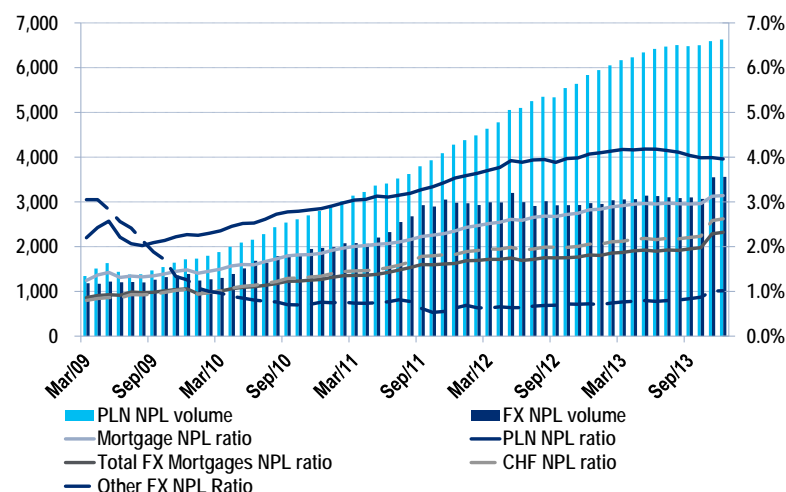
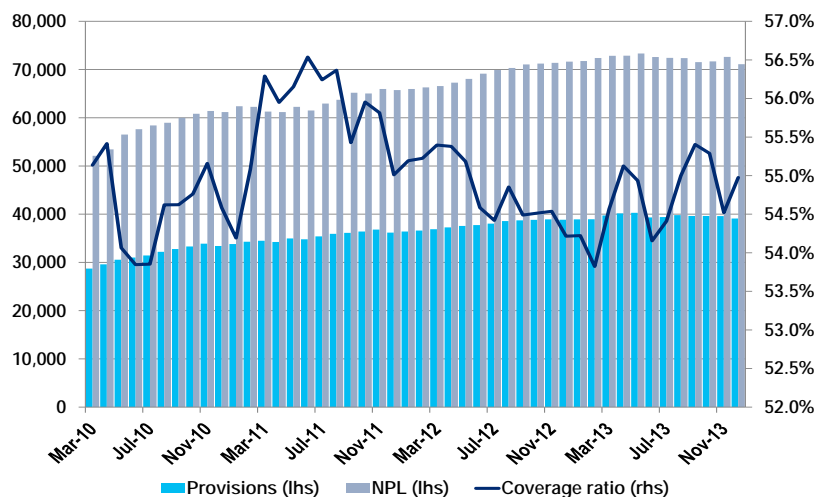
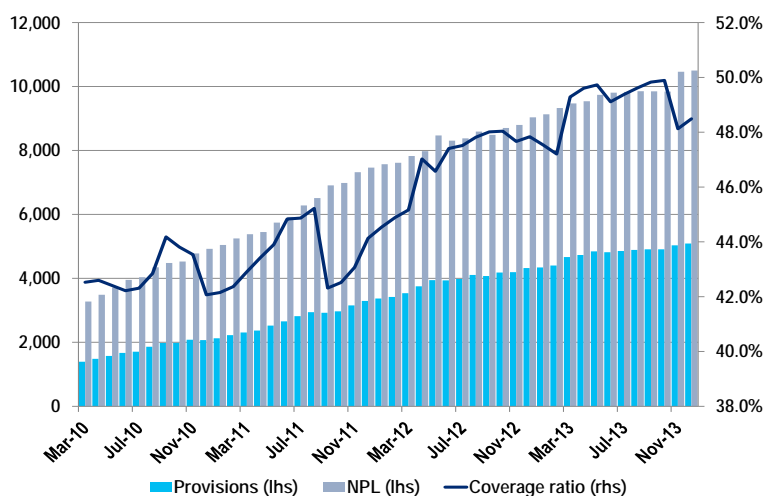


Figure 40. Polish Banks – Total Loans Coverage Ratio, Provisions and NPL, Mar 09 - Dec 13
(Polish Zloty in million, Percentage)



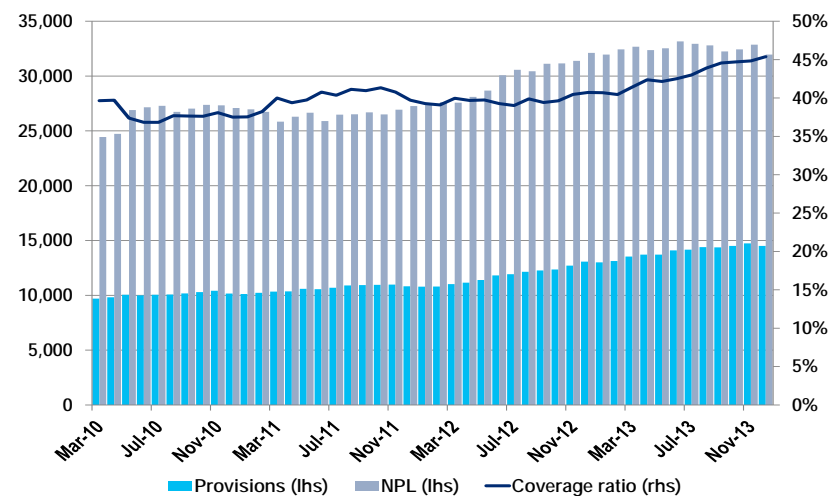
Source: NBP and Citi Research

Figure 42. Polish Banks – Mortgage Loans Coverage Ratio, Provisions and NPL, Mar 09 - Dec 13
(Polish Zloty in million, Percentage)



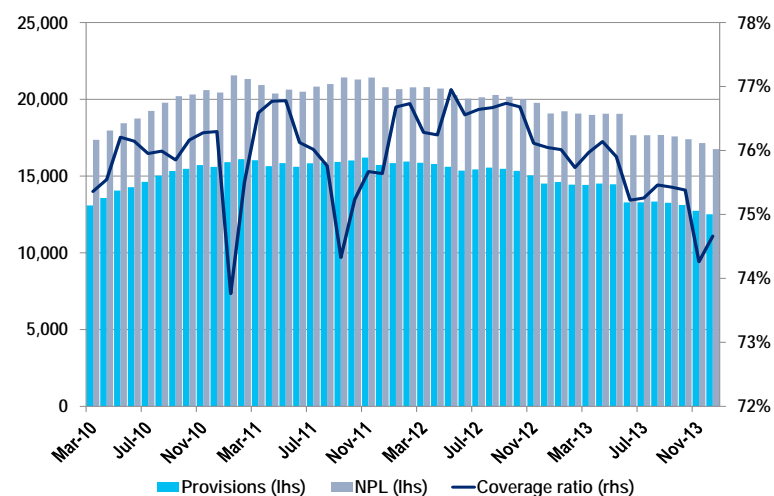
Source: NBP and Citi Research

Figure 41. Polish Banks – Corporate Loans Coverage Ratio, Provisions and NPL, Mar 09 - Dec 13
(Polish Zloty in million, Percentage)



Source: NBP and Citi Research

Figure 43. Polish Banks – Consumer Loans Coverage Ratio, Provisions and NPL, Mar 09 - Dec 13
(Polish Zloty in million, Percentage)



Source: NBP and Citi Research

Figure 44. Polish Banks – Consumer NPL Ratios, Dec 09 - Dec 13 (Percentage)

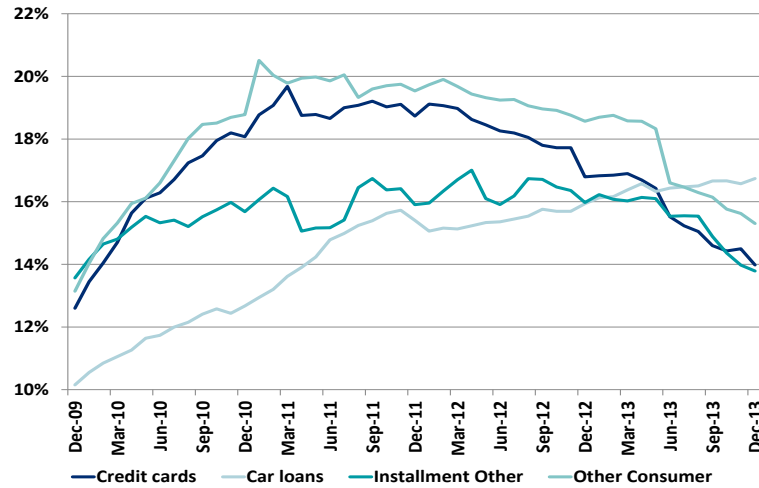
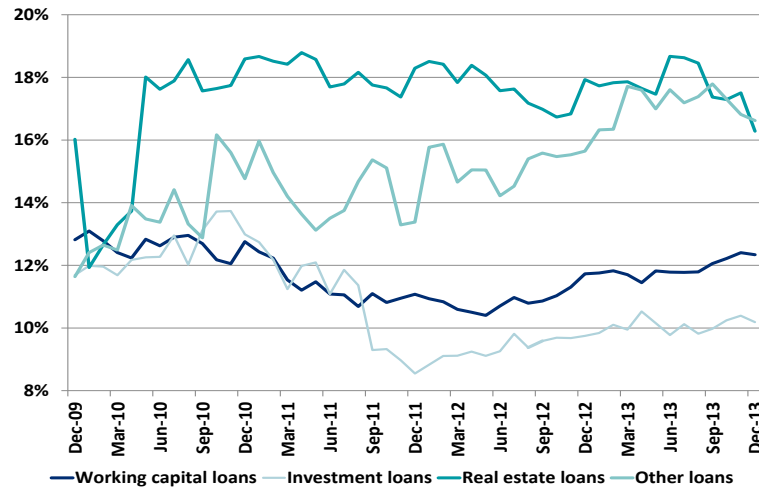


Figure 46. Polish Banks – Mid-cap Companies' NPL Ratios, Dec 09 - Dec 13 (Percentage)



Source: KNF and Citi Research

Figure 45. Polish Banks – Other Retail NPL Ratios, Dec 09 - Dec 13 (Percentage)

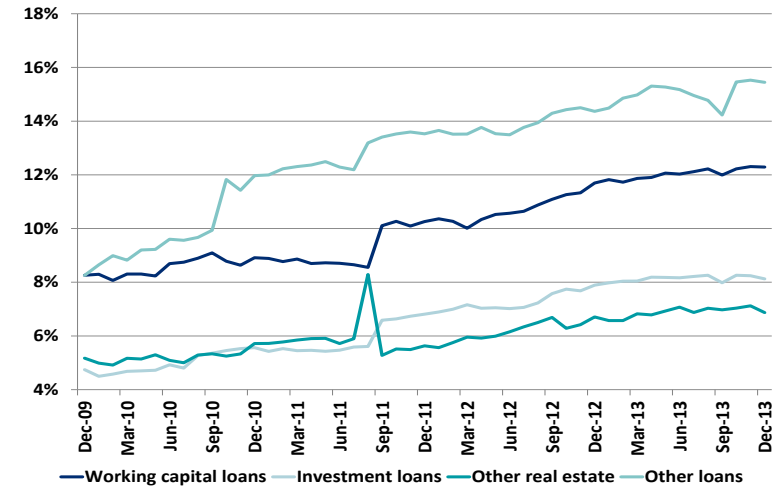
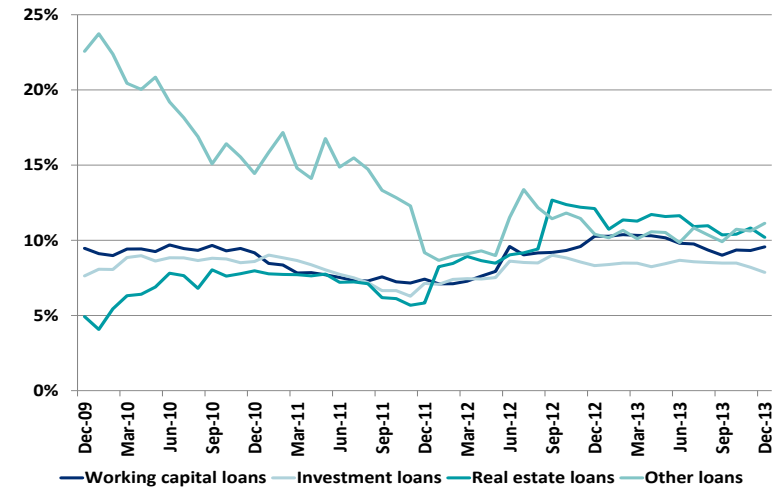


Figure 47. Polish Banks – Large Companies' NPL Ratios, Dec 09 - Dec 13 (Percentage)

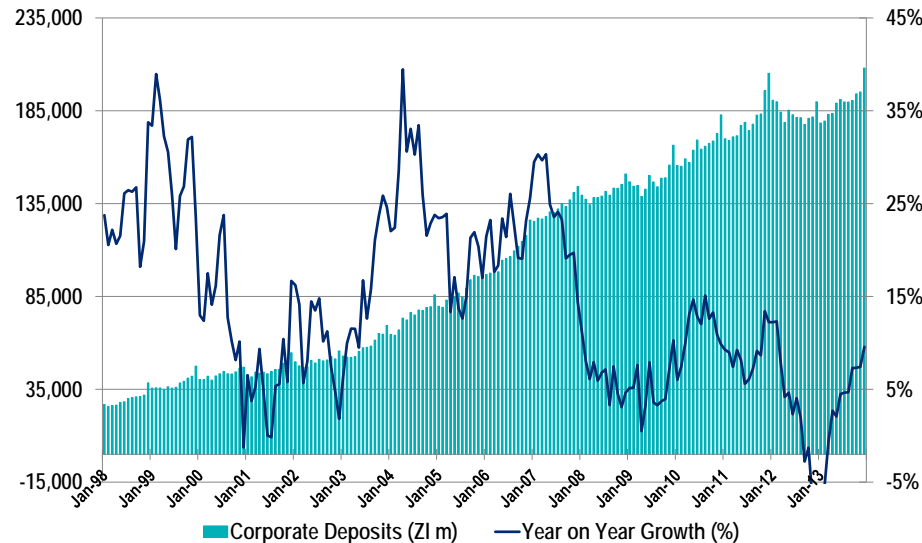


Source: KNF and Citi Research

Strong Increase of Corporate Deposits

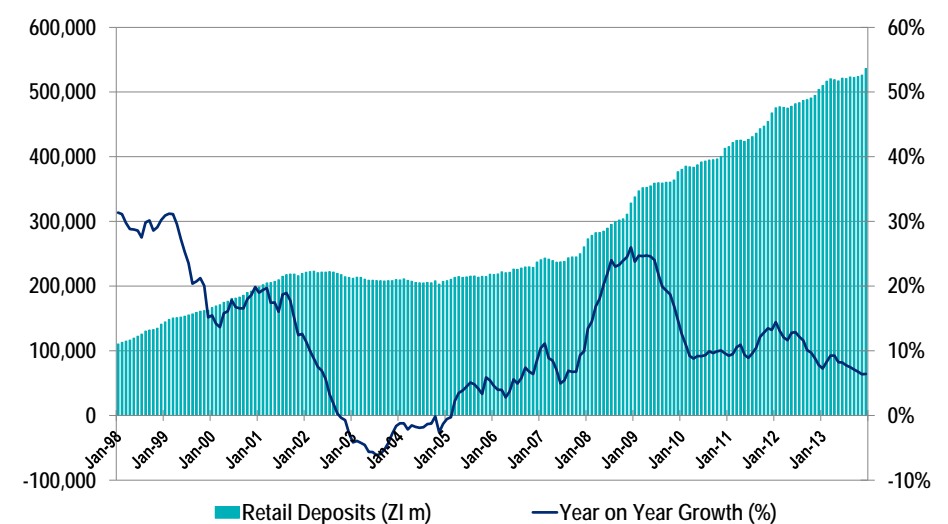
- In December 2013 corporate deposits grew to ZI 208.0bn (+6.6% mom vs. +0.5% mom in November), driven by seasonality, but we note that the annual growth rate also materially rose to +9.6% yoy vs. +7.4% yoy in the previous month.
- Total retail deposits increased in December to ZI 536.5bn (1.9% mom, +6.4% yoy vs. +0.4% mom and +6.6% yoy in November). The monthly net increase in retail deposits was ZI +10.3bn (vs. ZI +2.2bn in November and ZI +9.5bn in December 2012) and the cumulative 12-month growth was ZI 32.3bn (vs. ZI 31.6bn at the end of November).

Figure 48. Polish Banks — Corporate Deposits, Jan 98-Dec13 (Polish Zloty in millions)



Source: NBP, Citi Research

Figure 49. Polish Banks — Volume and Growth of Retail Deposits, Jan98-Dec13 (Polish Zloty in millions)



Source: NBP, Citi Research

Investment Funds – AUM Grew Despite Market Drop

- Despite negative market performance in December 2013 (WIG dropped 6.25% mom) the AUM of investment funds rose to ZI 189.0bn in December 2013 from ZI 182.9bn in previous month.
- In December 2013 inflows to investment funds amounted to ZI +6.8bn vs. ZI +4.7bn in November. This month flows were driven by inflows to one dedicated fund (ZI +5.9bn). In the area of divisional flows the highest value of inflows was noticed by mixed-funds (mainly due to transfer of PZU's funds from equity funds).
- The annual growth rate in AUM decreased in December to +29.6% from +30.1% yoy in November and the cumulative 12-month change in AUM grew to ZI 43.2bn from ZI 42.3bn in the previous month.

Figure 50. Poland — Investment Fund AUM, Jan 02-Dec13 (Zloty in millions)

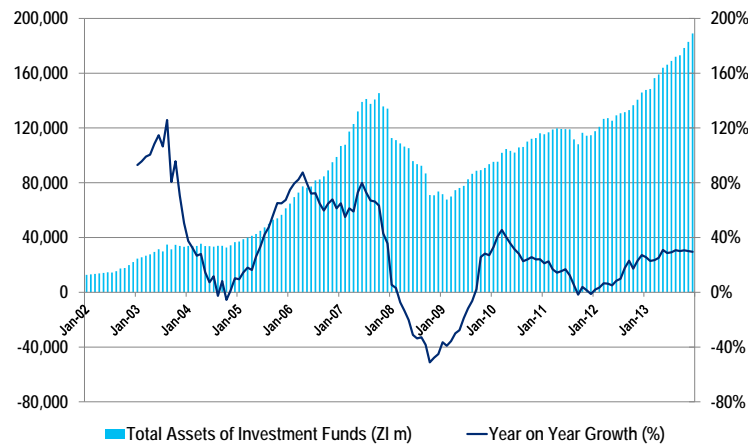
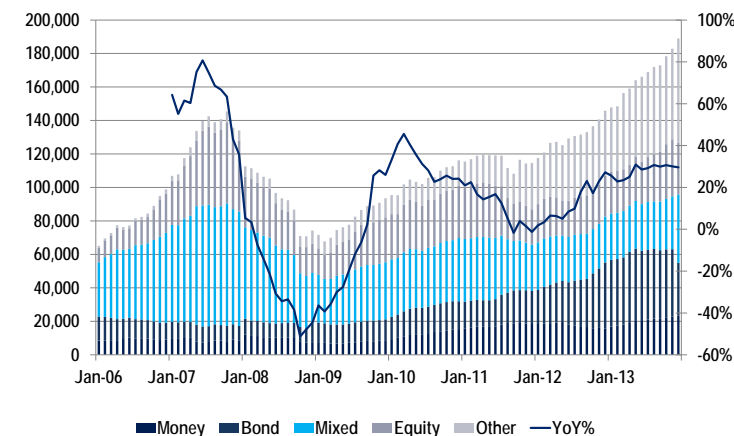


Figure 52. Poland — Investment Fund AUM Structure, Dec03-Dec13 (Polish Zloty in millions, Percentage)



Source for all: Polish Chamber of Fund and Asset Management, Citi Research

Figure 51. Poland — Investment Fund Flows, Dec 05-Dec13 (Zloty in millions)

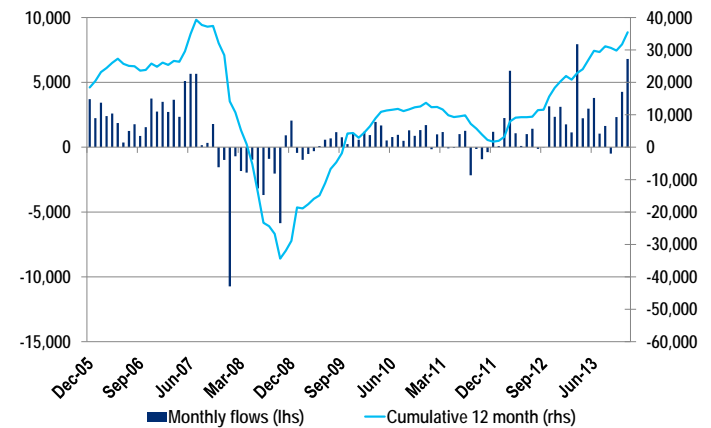
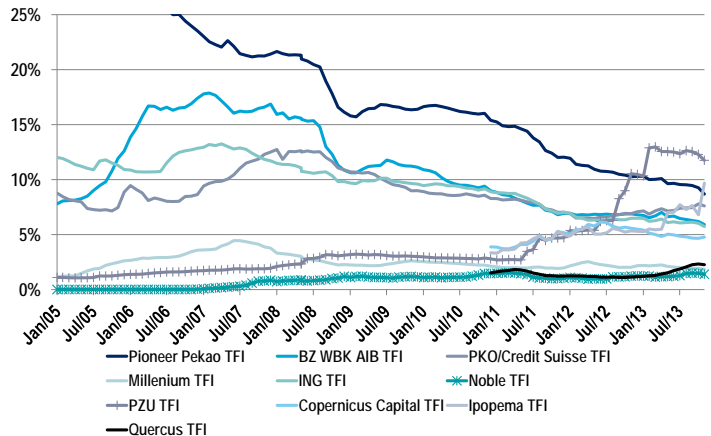


Figure 53. Polish Banks — Market Share in Investment Fund AUM, Jan05-Dec13 (Percentage)



Banking Sector Results: 2013 Profits -1% Due to Lower NII

- The Dec. 2013 banking sector net profit grew 96% yoy to Zł 1.4bn mainly due to one-off gains on sales of tangible assets. General costs increased 8% yoy while provisioning grew by 9% yoy.

- The sector's 2013 net result declined 1% yoy compared to 2012 as declines in net interest income (-4% yoy) and net fee income (-2% yoy) were only partly offset by lower provisioning (-15% yoy) and general costs (-1% yoy).

- In 2013 we expect the net profit of our universe of 7 Polish banks to decline by -4% yoy mainly due to lower NII (-8% yoy).

Figure 54. Polish Banks – Results of the Banking Sector, Dec12 - Dec13 (Polish Złoty in billion, Percentage)

	Dec-12	Nov-13	Dec-13 mom	yoy	YTD	YTD Yoy	
Assets	1,350	1,421	1,407	-1%	4%	1,407	4%
Equity	147	152	154	1%	5%	154	5%
Gross loans for non-fin	810	844	839	-1%	3%	839	3%
Amount due to non-fin	724	754	775	3%	7%	775	7%
Net interest income	2.7	2.8	3.4	20%	25%	34.1	-4%
Net fee income	1.2	1.2	1.0	-17%	-16%	14.0	-2%
General costs	-2.3	-2.3	-2.5	9%	8%	-27.6	-1%
D&A	-0.2	-0.2	-0.2	-1%	5%	-2.6	2%
Provisions	-0.8	-0.7	-0.9	33%	9%	-7.6	-15%
Net profit	0.7	1.0	1.4	31%	96%	15.4	-1%

Figure 56. Polish Banks – Net Interest Income, Net Fee Income and Other Income, Jan11 - Dec13 (Polish Złoty in billion)

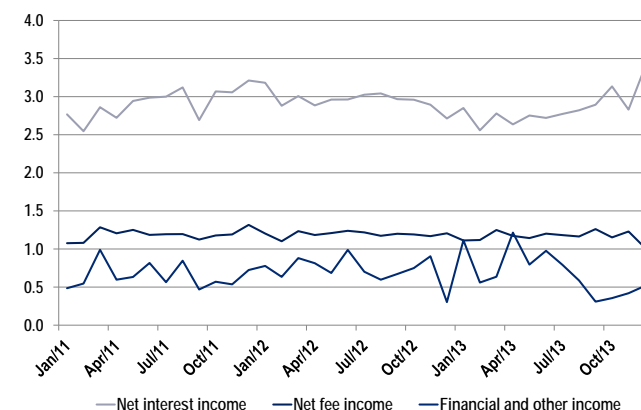


Figure 55. Polish Banks – YTD Yoy Dynamics of Net Profit, Net Interest Income, Net Fee Income and Provisioning, Jan12 - Dec13 (Percentage)

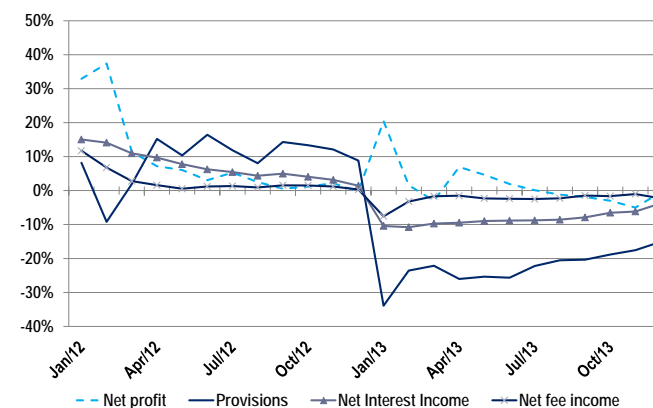
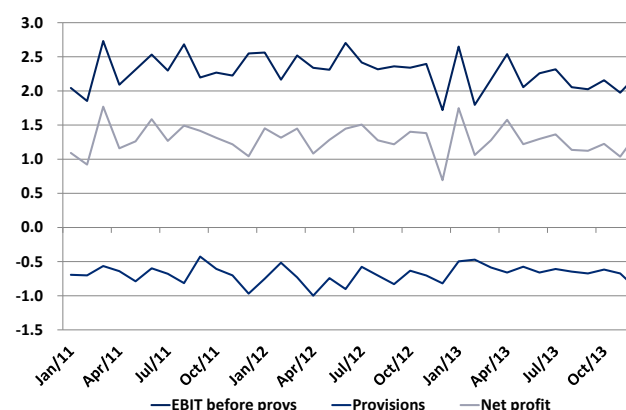


Figure 57. Polish Banks – EBIT Before Provisions, Provisions and Net Profit, Jan11-Dec13 (Polish Złoty in billion)

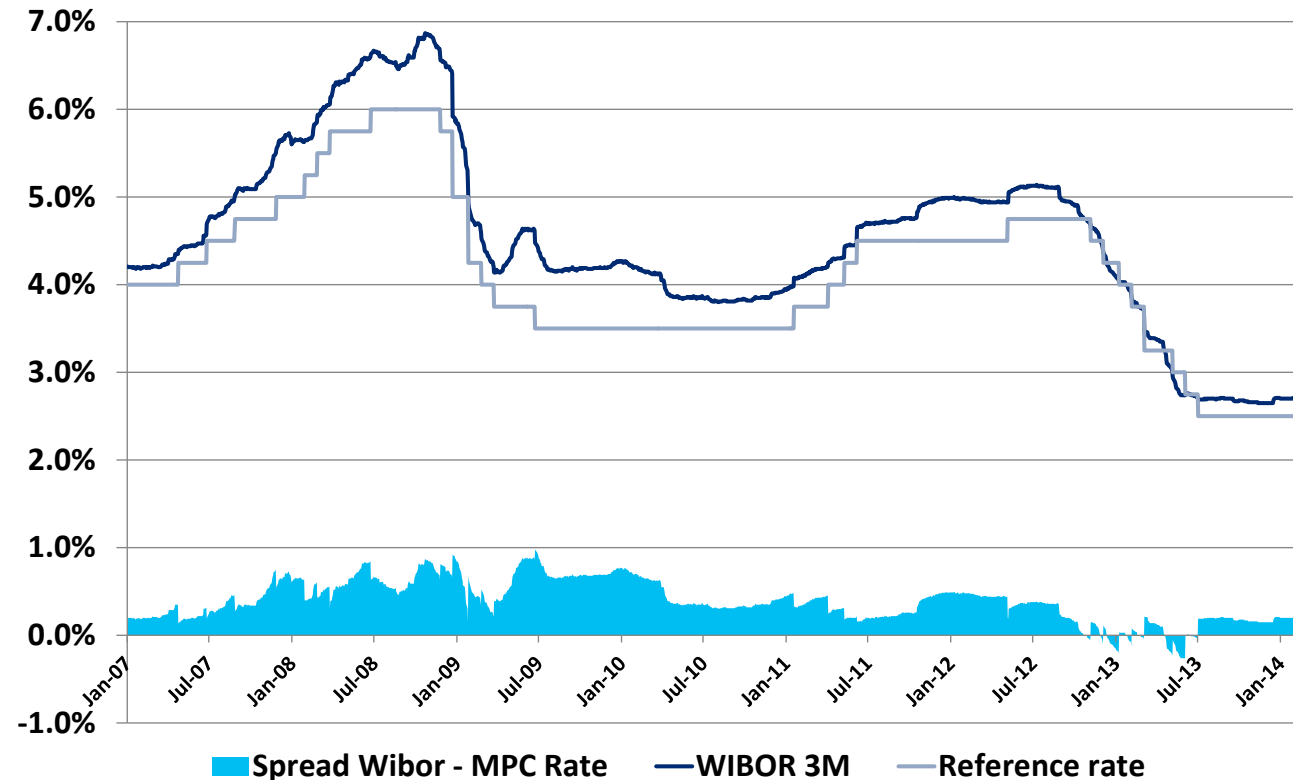


Source for all: KNF, Citi Research

Rate Cycle: Bottom of the Cycle

- At its February meeting the Monetary Policy Council (MPC) did not change interest rates (reference rate 2.5%). According to Citi economists, the monetary policy easing cycle is complete and the next rate move upward is likely to be in 3Q14.
- 3M WIBOR was at 2.71% on 31 January 2014, declining 243bp from its 2012 peak (5.14%) and 4bp higher than 4Q13 average (2.67%).

Figure 58. Polish Banks – Central Bank Reference Rate and WIBOR 3M, Jan 07-Jan14 (Percentage)

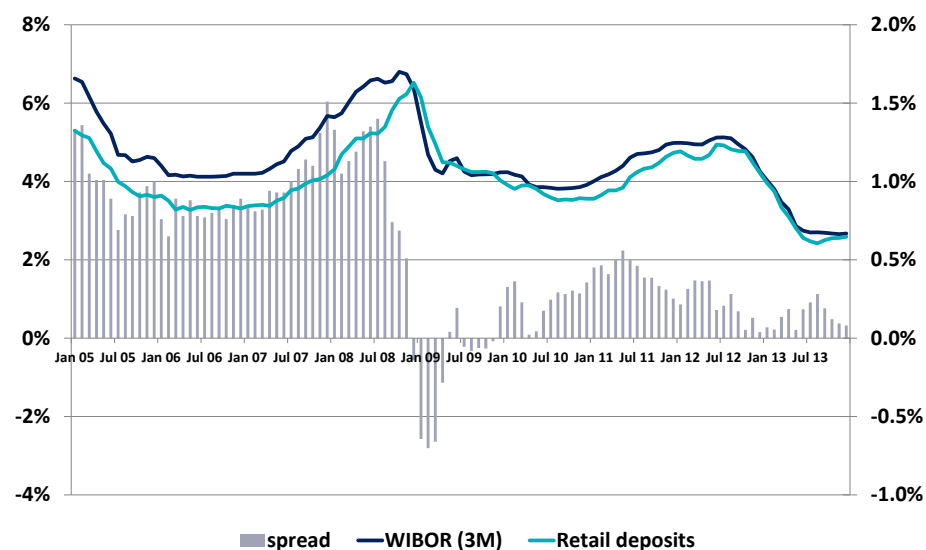


Source: Reuters, NBP, Citi Research

Spread Evolution – Decreasing Retail Deposits Spread

- In December 2013 the spread on new term (1-3 month) retail deposits decreased to -9bp vs. -18bp in November and -59bp in December 2012.
- In December 2013 the spread on new mortgage loans was flat at 2.49% as in previous month and in September 2013 but higher than in December 2012 (2.36%). We expect mortgage margins to remain around this level as banks price-in the higher cost of funding.
- According to NBP data, the spread on new corporate lending grew to 1.76% from 1.61% in November 2013 (vs. 1.93% in December 2012). Due to low demand for loans and the banks' appetite for lending, positively affected by relatively low cost of risk, we expect the spread on corporate loans to come under pressure in the coming months.

Figure 59. Polish Banks — Interest Rates on Retail Deposits (New Deposits), Jan05-Dec13 (Percentage)



Source: NBP, Reuters, Citi Research

Figure 60. Polish Banks — Interest Rates on Retail Deposits (Outstanding Deposits), Jan05-Dec13 (Percentage)

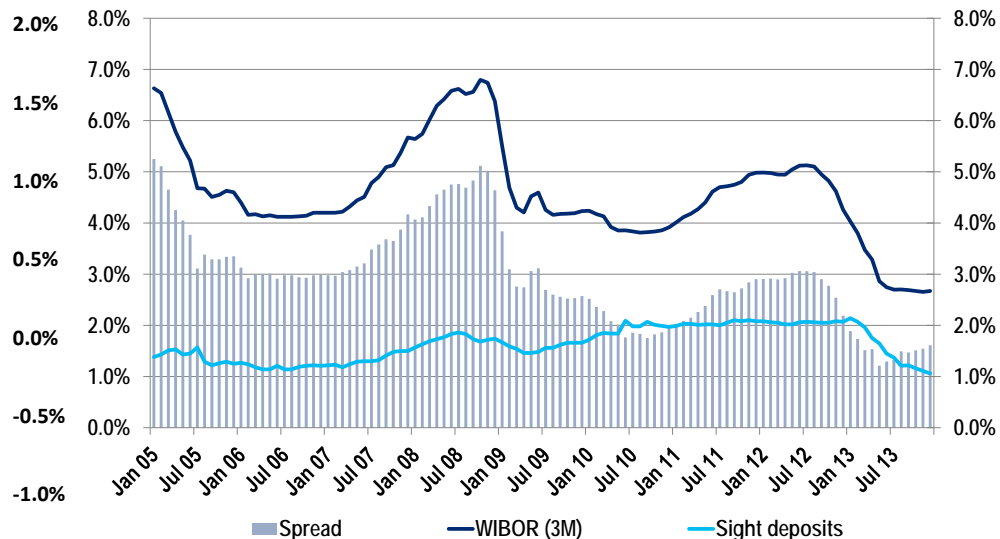


Figure 61. Polish Banks – Interest Rate on Zloty-Denominated Corporate Loans (New Lending), Jan05-Dec13 (Percentage)

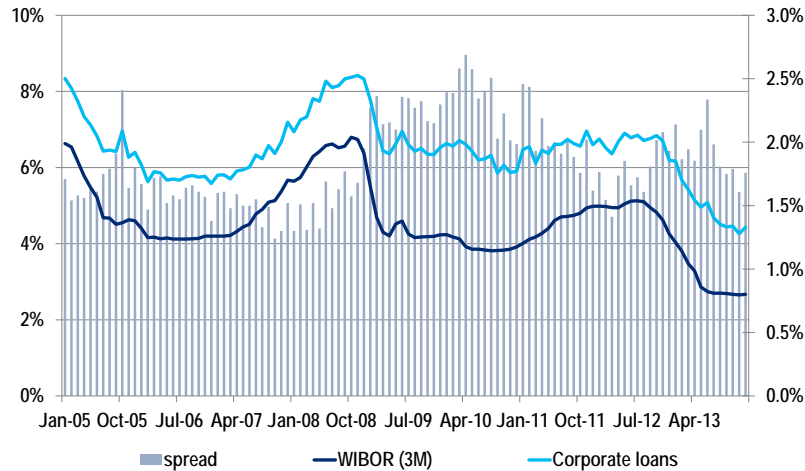


Figure 62. Polish Banks – Interest Rate on Zloty-Denominated Corporate Loans (Outstanding Lending), Jan05-Dec13 (Percentage)

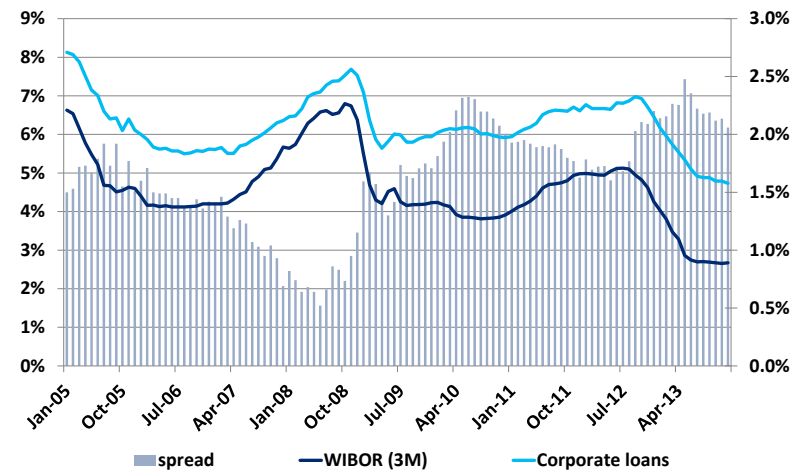


Figure 63. Polish Banks – Interest Rate on EUR-Denominated Mortgage Loans (New Lending), Jan07-Dec13 (Percentage)

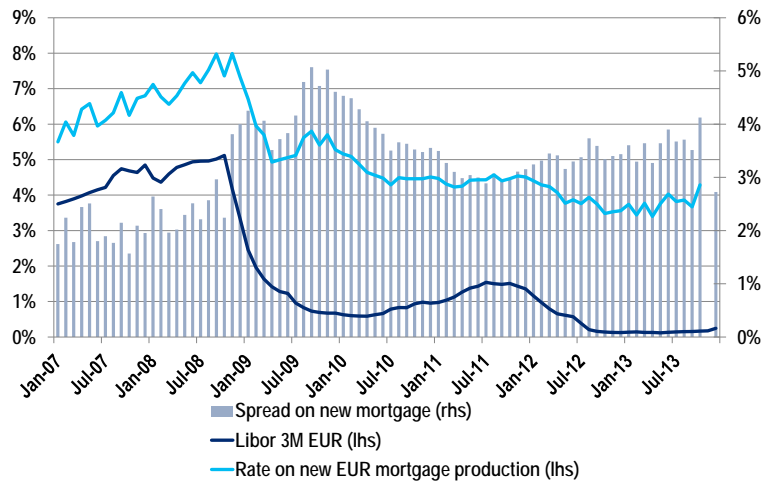
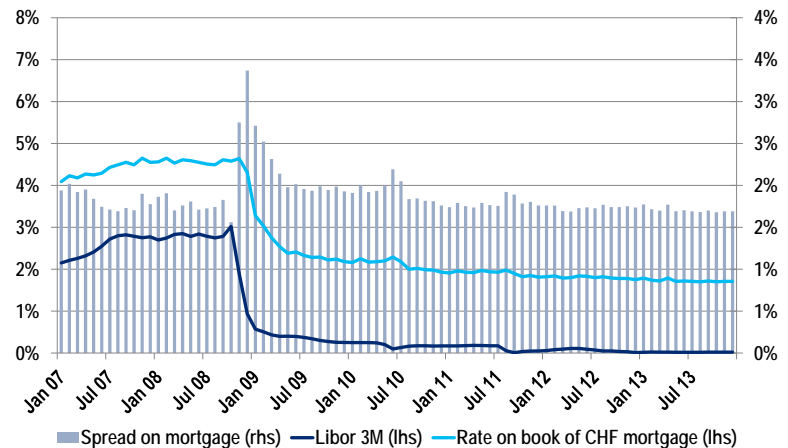


Figure 64. Polish Banks – Interest Rate on CHF-Denominated Mortgage Loans (Outstanding Lending), Jan07-Dec13 (Percentage)



Source for all: NBP, Citi Research

Appendix A-1

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